CARP Submission to the Department of Finance: Target Benefit Pension Plans

A stated goal of the Government of Canada in consulting with Canadians on the introduction of TB plans is to promote “the retirement income security of Canadians”. Target Benefit (TB) plans, however, without adequate protective measures for members and a real commitment from employers, are unlikely to be the solution and may undermine that goal.

The core goal of any pension system should be to provide adequate retirement savings to prevent poverty in old age. It must be affordable to contributors and robust enough to withstand major shocks, including economic, demographic and political volatility.[i] Broad, if not universal access and widespread enrolment in any new retirement savings vehicles should be a primary goal of pension plan reform.

If the Government of Canada wants to promote retirement income security through a new Target Benefit pension plan, then the following principles must be a part of the solution:

1. Accountability: A Target Benefit plan should be truly ‘shared risk’ between employers and employees, not just employees. It should provide a governance role and negotiating role for members and accountability to plan members;
2. Professional management: It should be managed professionally with a focus entirely on optimal performance, along with low management and administration fees. It should have measures in place to protect the plan from mismanagement and to promote long term sustainability;
3. Large, pooled funds: It should be large enough to increase investment returns and ensure greater fund stability;
4. Dependable, predictable benefits: It should aim to provide members with reliable target benefits to make retirement planning easier and more secure;
5. Protect accrued and retiree benefits: Every Canadian should be able to rely on their pension in retirement. All pension plans must commit to protecting the accrued employee and earned retiree benefits.

For federally regulated industries that currently offer no pension plan, TB plans that adhere to these principles may prove to be a significant new source of retirement income security.

The Federal Target Benefit proposed in the consultation paper falls short of the goal of securing retirement income. The Federal Target Benefit proposal currently represents much more risk to plan members than do existing Defined Benefit (DB) plans. Unlike DB plans, TB plans put most of the risk on plan members and do not promise a defined, legally protected benefit. Plan risk and volatility is borne largely by plan members who are subject to benefits cuts, reductions or elimination of guaranteed cost of living increases, and loss of ancillary benefits, capped contributions and little governance sway or negotiating power. Retirees may also be subject to a reduction in benefits in plans that underperform, creating considerable long-term financial insecurity.

Target benefit plans on their own are not necessarily a poor pension option, especially in the absence of any plan and in comparison to private options like RRSPs and defined contribution plans. But in order to positively contribute to retirement income security in Canada, TB plans must do more to protect plan members and retirees.

CARP is also concerned that the federal TB pension proposal will encourage federal agencies and corporations – most of which have defined benefit plans – to convert to TB simply because it could allow the organization to rid itself of unpaid pension liabilities, in the process transferring onus, risk, and reduced benefits to plan members and further destabilizing retirement income security for affected plan members. Target Benefit plans should not be used as a substitute for existing DB plans.

CARP Recommendations

1. Stabilize and sustain existing Defined Benefit pension plans, and protect the benefits of all current and retired plan members.
2. Design Target Benefit plans to be accountable to plan members, with risk shared by employers and employees, and to provide predictable, dependable benefits that cannot be reduced after retirement.
3. Limit Target Benefit plans to federally regulated industries that currently offer only a Defined Contribution plan or no pension plan at all.

Eroding Defined Benefit Plans

Compared to DB plans, TB plans are considerably more risky and much of the increased risk is shouldered by employees. Unlike the defined, legally protected retirement income promised by DB plans, TB plans aim for a 'target' pension based on shifting projections and unknown actuarial formulas. Benefits can be reduced if the target is unachievable and uncertainty is high.

In other jurisdictions where TBs have been introduced, namely Alberta and New Brunswick, contributions have been capped, further increasing the likelihood that benefits will be reduced if investment returns decline. The Alberta government proposal on TB plans would not only place all the risk on members, but it would simultaneously weaken the governance and negotiating powers of plan members and their union representatives.

Older employees caught in the conversion from DB to TB can often be put in a position in which they are expected to pay more for reduced benefits, thereby directly eroding their earned benefits.

All of this works to undermine both the financial and psychological security provided by Defined Benefits that can be counted on during retirement. These features of TB plans when compared to DB plans will make it more difficult for affected plan members to plan for and to feel financially secure in retirement.

The Importance of Strong DB Pensions

Workplace pension plans, especially Defined Benefit plans, have historically played an important role in helping Canadians achieve a sufficient and dependable source of retirement income. In the private sector, there has been a trend towards replacing DB plans with DC plans for new employees and fewer Canadians have access to safe, predictable, pension plans. Inviting the public and private sectors to convert DB plans to TB plans will further reduce the stabilizing effect robust pension plans have on retirement income security.

- Two-thirds of the Canadians workforce -12 million people - do not have workplace pension plans.[ii]
- In the 15 years from 1995 to 2010, the percentage of Canadians with workplace pension plans declined from 34 percent to 32 percent.[iii] The occupational pensions that do remain are increasingly Defined Contribution (DC) rather than Defined Benefit (DB), exposing personal retirement funds to greater risk of market volatility.

Canadian DB plans contribute considerably to society and the economy. Most importantly, DB plans provide a singularly important source of retirement security:

- **DB plans reduce pick-up of government benefits:** 10-15% of DB beneficiaries collect the GIS, compared with 45-50% of other Canadian retirees.[iv]
- **DB plans largely pay benefits from investment returns:** As much as 80 cents of every pension dollar from studied pension plans comes from investment returns.[v]
- **The DB advantage:** Pooling longevity risk and pooling asset risk allows plan members to save “at a collective rate consistent with the average life expectancy or distribution within the group. Similarly with asset risk, DB plans can typically maintain an asset mix reflective of the group rather than any one individual. Both advantages provide stability for members, allowing for a consistent standard of living throughout their lives,” according to a report on DB plans by Boston Consulting Group.[vi]

The 2008-9 market downturn put many pension funds into deficiency leading to criticism that DB pension plans are fundamentally unsustainable. However, most large funds have rebounded.

A new study[vii] shows that Canadian DB plans are outperforming international counterparts and that funding status is improving, undercutting the impetus for the introduction of TB plans:

- **DB plan funding status is improving:** In 2013, the funded status for DB plans rebounded from a low in 2012, climbing to 88.4% and matching the pre-recession funding level attained in 2005. In 2012, the funded status for Canadian DB plans fell below the 80% threshold for the first time in a decade.
- **Employer contributions are decreasing:** Total employer contributions decreased in 2013, down $22 billion year-over-year to $67.8 billion. The study notes that "remarkable asset performance and higher discount rates during the year alleviated the pressure on sponsors to maintain the record high contribution levels from 2012."
- **Canadian DBs outperforming international plans:** The study found that Canadian DB plans have a higher funded status than U.S. plans and other international plans reviewed.

CARP Member Polling

CARP members have a personal and financial stake in any pension plan conversion but they also have the benefit of experience, living and managing finances in retirement. Pension issues are a top priority for CARP members.

Members in New Brunswick, and now in Alberta, are witnessing first hand the kind of benefit erosion and threat to DB plans that can occur in conversion from DB to TB. With the federal introduction of TBs, CARP polled members on pension plan conversion and Target Benefits, finding that that majority of CARP members worry that TB plans are being introduced specifically to undermine DB plans.[viii]

- **Most CARP members have pensions:** Almost 80% of CARP members polled have pensions. Two-thirds of these members have DB pensions (66%) and more than 40% have public sector DB plans.
- **Low support for TB plans:** The majority of CARP members polled (54%) do not think that TBPs are a viable alternative to DB plans. Only one-third of members polled support TBPs.
- **DB plans threatened:** The main reason CARP members don't support TBPs is because of the risk they pose to DB plans. 33% think that TBPs will be used to undermine DB plans.
- **TBPs will be used only to undermine DB plans:** Very few members think that employers who do not currently offer any pension plan, will choose to offer TBPs.
- **Keeping the pension promise:** Virtually all CARP members polled (91%) think that it is very important that an employer deliver on pension commitments.

- **Higher Contribution preferred over lower benefits:** Two thirds of members (66%) would choose increased contributions over reduced benefits, given the implicit trade-off in TB plans. Only 9% would choose to pay lower contributions for a reduced benefit.

Canadians are not Saving Enough for Retirement

Canadians are not saving enough privately for retirement and the Canada Pension Plan (CPP) and other public sources of retirement income are often insufficient means of achieving a financially secure retirement.

Private savings options, such as Registered Retirement Savings Plans (RRSPs) have not been the answer to retirement security. In 2011, Canadians contributed $34.4 billion to RRSPs, which was only 4.5% of the total room available to eligible tax-filers. In effect, Canadians have left $738 billion of RRSP contribution room untouched.

The CPP pays a maximum of approximately $13,000/year, but most people receive closer to $7000/year. The guaranteed Income supplement helps support very low income seniors with earnings less than approximately $17,000/year. Old Age Security will be delayed by two years starting in 2023. Many Canadians, as a result, may be unprepared financially for retirement and may experience significant drops in standard of living.[ix]

Canadians who belong to DB plans have the added retirement security of a defined income throughout retirement. No one is helped by leveling the pension field by driving down the retirement security of those who have it. In pursuing retirement income security for all Canadians, the federal government should work to shore up existing DB plans and to offer TB plans only as an upgrade for employers currently offering no pension plan or DC plans.

Helping Canadians Achieve Retirement Income Security

In addition to protecting existing DB plans, the federal government can play an integral role in helping Canadians save for their own retirement.

In 2009, CARP proposed the creation of a supplementary Universal Pension Plan (UPP). CARP's UPP would provide Canadians a large pool of funds that is big enough to provide more protection against market volatility and shocks and produce higher investment returns than small, individual savings accounts, Pooled Registered Pension Plans, and other retail investment options.

A UPP, modeled on the CPP but not necessarily part of the CPP, would provide dependable and predictable benefits allowing Canadians to better plan for retirement.

Such a plan would provide Canadians true portability across jobs and provinces. CARP's UPP model would help Canadians save and prepare for retirement by providing supplementary retirement savings through a large national plan.

The core goal of any country's pension system, as mentioned above, should be to provide adequate retirement savings to prevent poverty in old age. It must be affordable to contributors and robust enough to withstand major shocks, including economic, demographic and political volatility.[x] Universal access and widespread enrolment in any new retirement savings vehicles designed to provide adequate and predictable retirement income should be a primary goal of pension reform. CARP's model for a UPP would accomplish these goals.

Enact modest CPP enhancement

The federal government has so far failed to consent to a modest increase in the Canada Pension Plan, but CPP enhancement is crucial to helping Canadians secure for themselves a higher baseline of retirement income.

The CPP, which already shares many of the features of CARP's UPP, should be modestly enhanced to further help all working Canadians retire securely, in addition to a UPP. The CPP is professionally managed by the CPP Investment Board (CPPIB) and is independent of government. It provides predictable benefits to help people prepare and plan for retirement and is available to all working Canadians, with full portability across jobs and provinces.

The CPP fund is robust and well-funded, with all benefits for the next decade to be paid with investment returns alone, leaving accumulating contributions untouched. It is currently one of the most efficient pension systems.

Conclusion

Target Benefit plans should not be allowed to replace existing Defined Benefit plans. TB plans as proposed are inherently more risky, pass on much of that risk to employees, and produce less certain and lower pension benefits than do DB plans.

Target Benefits have a role to play in the pension landscape, but they are best suited to federally regulated employers who do not currently have a pension plan or that only offer employees a Defined Contribution plan. If the Government of Canada wants to promote retirement income security through a new Target Benefit pension plan, then it is crucial that they incorporate into the plans accountability and a governance role for members, professional management, dependable and predictable benefits, and protection for all accrued and earned benefits for current and retired members.

Who We Are

CARP is a national, non-partisan, non-profit organization committed to a 'New Vision of Aging for Canada' promoting social change that will bring financial security, equitable access to health care and freedom from discrimination. Our mandate is to promote and protect the interests, rights and quality of life for Canadians as we age.
CARP has 300,000 members across Canada.

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