



Security, Adequacy, Fairness: Labour's Proposals for the Future of Canadian Pensions



A CLC Discussion Paper



Canadian Labour Congress
Congrès du Travail du Canada

July 2009



Table of Contents

Introduction.....	1
1. Double benefits for the Canada Pension Plan (CPP).....	4
2. Increase low income public pensions (GIS) by 15% so no senior lives in poverty.....	4
3. Protecting Canadian pensions through a federal system of pension insurance.....	4
Details of Labour's Proposed Plan.....	5
1. Double benefits for the Canada Pension Plan (CPP).....	5
Summary.....	5
Why we need it.....	6
1.1 The CPP offers secure and predictable pension benefits.....	6
1.2 The CPP offers portability of pension benefits across jobs.....	7
1.3 The CPP offers a pan-Canadian solution to a pan-Canadian problem.....	8
1.4 An improved CPP offers the most for young workers.....	8
1.5 The CPP offers protection against the rising costs of living.....	9
1.6 CPP is a better deal than costly RRSPs.....	10
1.7 An enhanced CPP will shore-up employer plans.....	11
How it would work.....	11
2. Increase low income public pensions (GIS) by 15% so no senior lives in poverty.....	13
Summary.....	13
Why we need it.....	13
How it would work.....	16
3. Protecting Canadian pensions through a federal system of pension insurance.....	16
Summary.....	16
Why we need it.....	17
How it would work.....	18
Conclusion.....	20

Security, Adequacy, Fairness: Labour's Proposals for the Future of Canadian Pensions

A CLC Discussion Paper

Introduction

The global economy is in its deepest downturn since the 1930s. Many Canadians are fearful that they may retire without adequate pensions or even fall into poverty. Hundreds of thousands of good-paying jobs have been lost, and the pensions of millions of Canadians have been put at risk by the financial meltdown and a wave of employer bankruptcies. Even those with jobs are wondering if and when they can ever retire.

Without question, recent events have exposed major faults at the heart of our pension system. Our public pension system — Old Age Security (OAS) and the Guaranteed Income Supplement (GIS) plus the Canada Pension Plan — provides a secure income in retirement, but the maximum value of public pensions falls well short of replacing the 50% to 70% of pre-retirement income needed to maintain decent living standards. Compared to many other advanced industrial countries, our public pension system is very underdeveloped.

The private part of our pension system, which was meant to make up the big difference between public pensions and adequate retirement incomes, is in deep trouble. Only about one in five workers in the private sector now belong to an employer pension plan. Very few non-union workers, with the exception of managers and professionals, are covered by an employer plan. Many of the plans which do exist are on shaky financial ground because of low interest rates and the recent collapse of stock markets. Some workers covered by pension plans find that there is no effective backstop when plans get into financial trouble.

While most employer plans still provide a defined benefit, there has been a shift to defined contribution plans that resemble RRSPs in terms of high risks, high costs, and very uncertain outcomes.

RRSPs were sold as the solution to our pension woes. Yet the average older worker approaching retirement today has saved enough to buy a monthly pension of only about \$250 per month. (The median RRSP value of a worker aged 55 to 65 was just \$60,000 in 2005. Half of RRSP holders have less than this amount.) RRSPs have failed to counter the decline of defined benefit pension plan coverage because many people do not save enough, because administrative fees and costs are very high, and because financial returns are highly variable and uncertain.

Despite improvements in recent decades, a disturbing number of vulnerable seniors — single women, First Nations, recent immigrants, and those with disabilities — still live in poverty.

The case for pension reform runs into strong opposition from the vested interests of the financial industry. However, the case for change is being increasingly heard by decision-makers. Many employers who sponsor pension plans recognize that the cost of supporting decent pensions through public rather than private arrangements would help level the competitive playing field between businesses and by reducing their costs of administering their private pension plans.

The labour movement believes that Canadians should not have to “fend for themselves” in retirement. After a lifetime of work, making a positive contribution to our country’s development, all Canadians deserve security and dignity in retirement.

The Canadian Labour Congress calls for a national summit of government, employers, labour, and others to discuss and bring forward a concrete plan to rebuild and reform our pension system.

This short paper outlines our proposals for change, championing the same progressive values which changed our health care system with the advent of Medicare in the late 1960s. Today, we can make a similar choice for pensions, and create a system where no Canadian is left behind.

Our priorities for change call for a major shift from private to public pensions, and greater security for members of existing employer pension plans. The changes we propose would benefit all workers, providing greater security while making our pension system better fit the needs of a changing economy.

- **Security of pension benefits:** all Canadians are entitled to the pension they've earned, and government must provide a base floor of pension security;
- **Adequacy in pension income:** regardless of personal circumstances, no senior (current or future) should live in poverty; public pensions including the Canada Pension Plan should replace an adequate portion of the average wage;
- **Fairness in pension outcomes:** one's skill at "playing the markets," misfortune to retire in a recession, or working for several employers shouldn't dramatically reduce pension income. We need fair pension outcomes for all Canadians, and measures to help those, like women, who do worse today.

With these values in mind, this paper outlines three key areas in which to improve Canadian pensions:

1. Double benefits for the Canada Pension Plan (CPP)

This would offer efficient, secure, and enhanced pension benefits to the 93% of Canadians who make CPP contributions, while also taking financial stress off workplace pensions moving forward. (The great majority of workplace plans are coordinated with CPP benefits, meaning that a defined benefit tops up the CPP pension benefit, with the employer plan making up the difference.) We propose to phase in a doubling of the proportion of average earnings replaced by CPP from 25% to 50% over seven to ten years to \$1,635 per month, financed by a modest increase in worker and employer premiums which would be fair for lower paid workers.

2. Increase low income public pensions (GIS) by 15% so no senior lives in poverty

Our proposal would move all seniors above the poverty line. Moving forward, since an improved CPP will provide better pension benefits, tax subsidies to RRSPs could be reduced to finance an increase in Old Age Security benefits paid to all workers.

3. Protecting Canadian pensions through a federal system of pension insurance

An insurance “floor” should be set for defined benefit pension benefits (to a proposed maximum of \$2,500 per month) through a system funded by contributions from pension plan sponsors. This would be a federal system initially covering federally regulated pensions, but the federal government should enter into negotiations with the provinces to create a national system. The pension insurance system should also take on the task of

administering abandoned pension plans from bankrupt employers with no prospects of recovery.

Pension insurance should be backstopped by a reserve fund financed through a small financial transfer tax on Canadian stock market transactions.

Details of Labour's Proposed Plan

1. Double benefits for the Canada Pension Plan (CPP)

Summary

According to Bernard Dussault, former Chief Actuary of the Canada Pension Plan from 1992 to 1998, an additional 5.5% of employment earnings in CPP contributions (split equally between workers and employers) could finance a doubling of CPP benefits on a go-forward basis from 25% to 50% of insured earnings. This would provide a much higher base floor of adequate and secure pension income.

As was the case with reforms to CPP contributions in 1998, this increase would be phased in, perhaps over a seven- to ten-year period. We also propose measures to offset the impact of a premium increase on low income Canadians.

While we need a national debate and strategy on pensions, it will ultimately be up to the federal government and the provinces to come up with a detailed plan to double the CPP. (Quebec runs

its own public pension plan, the QPP, which is similar in broad design to the CPP but is exclusively run by the Quebec government.)

Why we need it

1.1 The CPP offers secure and predictable pension benefits

Because the CPP is a defined benefit plan with a view to a long-time horizon and covering essentially all working Canadians, workers can count on their future CPP pension regardless of market returns.

Pension benefits are based on the amount of CPP contributions over a 47-year period, with some years of lowest earnings being dropped out for benefit calculation purposes. Service Canada has an online tool to calculate CPP contributions to date, and projected pension income.

RRSPs and privately run, defined contribution pensions can't match the extremely low administrative costs of the CPP. Nor can they offer the CPP's security given that the pension income they eventually provide varies with market returns and the rise and fall of interest rates. One's private pension can vary significantly given the performance of pension investments and the moment one chooses to retire.

To emphasize this point, Table 1 demonstrates what would happen to a worker retiring at two different moments in the current economic crisis with a \$100,000-RRSP or defined contribution (DC) pension. As we see, the penalty for retiring at the wrong time is substantial.

Table 1: The value of a \$100,000-RRSP or DC pension at two moments in time during the current economic crisis (TSX indexed funds)	
Date of retirement	Expected pension income
May 15, 2008	\$7,659.20 / year (or \$638.26 per month)
February 15, 2009	\$3,937.33 / year (or \$312.11 per month)

Canadians work hard, and are entitled to an adequate floor of pension security. One's luck at "playing the markets" or good fortune to retire at the right time should not determine whether a dignified retirement is possible.

1.2 The CPP offers portability of pension benefits across jobs

Unlike the vast majority of workplace pensions, CPP benefits are fully portable across jobs. One can work for several employers over time without suffering any loss of CPP pension income.

The portability of the CPP is a key way of ensuring fair pension outcomes given the reality of job turnover and uncertainty as to the future of individual employers in today's economy. When most workplace pensions were designed, it was conceivable to spend an entire career with the same employer. Today, this is rarely the case.

For decades, RRSP boosters have claimed the easy portability for RRSP benefits made them superior to workplace pensions. CPP benefits are also portable, but far better protected from the booms and busts of stock markets, and far less costly to administer than private plans due to the much larger economies of scale.

1.3 The CPP offers a pan-Canadian solution to a pan-Canadian problem

There is much talk today about the lack of decent pension coverage and the need for new solutions, yet 93% of Canadians are already members of a plan that works – the CPP and its Quebec counterpart, the QPP. Expanding the CPP is the best way forward. We need our federal and provincial leaders to continue the important public policy work that began in 1966 when the CPP was put in place.

Creating “voluntary” supplements to the CPP (as some have suggested) or new types of RRSP-style pensions will help those with higher income, but will not help those who need help the most. And most solutions on offer would not provide a defined pension benefit, nor a required employer contribution to better pensions.

It would also be unwise for some provinces to “go it alone” with their own pension options given the degree of worker mobility between provinces, and the need for a pan-Canadian solution. We don't need to add to the patchwork of our already fragmented pension system.

1.4 An improved CPP offers the most for young workers

Before reforms were being made to the CPP in the 1990s, young workers were told they couldn't count on receiving their CPP pension. Bank lobbyists led the charge, urging young workers to buy RRSPs to supplement what they wouldn't get in CPP benefits given the costs of ageing “baby boomers.”

Today, we see how loaded these comments were. The CPP is on solid financial terms until 2085, long after the baby boom wave of retirees will have been looked after. It is private pension arrangements, not the CPP, which are failing to deliver.

Doubling CPP benefits would gradually be of greatest help to workers who stand to make the most from higher CPP contributions over a working lifetime.

1.5 The CPP offers protection against the rising costs of living

In the mid-1970s, when inflation soared to double-digit levels, Canadians urged the federal government to better link CPP benefits to the rising costs of living. This demand was realized, and today CPP benefits are increased once per year to match increases in the Consumer Price Index (CPI). Meanwhile, most workplace pensions continue to lose value given the absence of inflation protection.

Some may think that today's low inflation rate means this issue is less important, but nothing could be further from the truth. The Canadian Institute of Actuaries (CIA) has shown how even low inflation can dramatically change the value of one's pension over time.

Table 2 shows how current levels of inflation can reduce a pension plan's value by almost 50% over a thirty-year period:

Table 2: Impact of inflation on \$1,000 in pension assets over time (CIA, 2007)					
Number of years	Value of \$1000 over time after inflation (1% - 4%)				
	0.0%	1.0%	2.0%	3.0%	4.0%
1	\$1,000	\$990	\$980	\$970	\$962
10	\$1,000	\$905	\$820	\$739	\$676
20	\$1,000	\$820	\$673	\$545	\$456
30	\$1,000	\$742	\$552	\$402	\$308

1.6 CPP is a better deal than costly RRSPs

As one of the largest pension plans in the world (with assets of \$105.5 billion, and billions of dollars in annual contributions), the CPP is in a position to deliver secure pension benefits at a low cost to Canadians.

Because the CPP doesn't have to account for the individual investment strategy for each CPP contributor, it is far more efficient than any RRSP or DC plan. In 2008, the administrative costs for the Canada Pension Plan Investment Board (or CPPIB) amounted to a tiny 0.25% of the entire value of the CPP Investment Fund.

In contrast, Canadian mutual funds that attract RRSP and DC plan investors carry the highest administration costs in the world. One study found the average Management Expense Ratio for Canadian mutual funds could consume 35% to 40% of a worker's RRSP savings over a forty-year period. Seemingly low fees of 2% to 3% take a huge bite out of annual returns of 5% or 6%. Clearly, the CPP offers a much better deal for Canadians despite

the protestations of the financial industry that they can make everyone rich.

1.7 An enhanced CPP will shore-up employer plans

The great majority of employer plans provide a defined benefit (usually a fixed proportion of final average earnings based on years of service) which takes into account the earnings replaced by the CPP. Doubling the CPP would thus gradually take some of the funding pressure off employer plans moving forward. This would help create a more level playing field between employers who sponsor plans and those who do not, while obliging all employers to make a contribution toward retirement incomes. Employers and unions would still be able to negotiate arrangements above the higher CPP floor, including replacement of earnings above the CPP earnings limit – which is important to those earning above the average – and also to provide benefits above and beyond the CPP, such as provisions for earlier retirement than under the CPP. A bigger CPP would, however, reduce dependence upon private pension arrangements which are much more likely to get into trouble.

How it would work

As was the case with CPP reforms in 1997, a premium increase could be phased in slowly over a number of years. The worker contribution might rise, from 5.33% in 2010, to 7.70% by as early as 2016. As is currently the case, the overall premium increase needed to finance a larger benefit would be evenly shared by workers and employers, while self-employed persons would contribute the full amount on their own.

By the end of this seven-year period, Canadians would be eligible to earn twice the benefit level currently available under the CPP for all future contributions. The enhancement, as Table 3 illustrates, is a substantial improvement:

Year	Maximum CPP benefit
2009	\$908.75 / month
2016	\$1,817.50 / month

Some have expressed concern about the impacts of even a small premium increase on lower paid workers.

To take this into account, the “Year’s Basic Exemption” for CPP contributions should be doubled (e.g., to \$7,000 from \$3,500) so that no premiums would be paid below a low-earnings threshold. And the tax credit for CPP contributions should be increased for lower paid workers.

Of course, given that the CPP is a contributory pension plan (not a “pay-as-you-go” public pension, like Old Age Security, as we discuss later), it will take much longer than seven years to qualify for a doubling of maximum CPP benefits. For that reason, this reform will primarily benefit younger workers.

With that in mind, we propose assisting older workers and current retirees through improvements to public pensions (OAS and GIS) and implementing a national system of pension insurance. We outline these proposals in more detail below.

2. Increase low income public pensions (GIS) by 15% so no senior lives in poverty

Summary

According to Monica Townson, one of Canada's leading pension experts, an increase of \$682 million to the Guaranteed Income Supplement (GIS) to Old Age Security (OAS) pensions would lift every senior over the Low Income Cut-off (or "LICO") line established by Statistics Canada. This increase would be permanent given that OAS and GIS benefits (like the CPP) are linked to the Consumer Price Index and protected against inflation.

Increasing the GIS would help stimulate the economy since low income seniors can be counted on to spend this new income. Part of the cost would thus be offset by higher government revenues.

Why we need it

Before elaborating on our proposed 15% increase in GIS benefits, further information about the OAS and GIS is necessary. Few Canadians understand how these important programs work.

The OAS and GIS work much differently than the CPP. They are financed directly from federal government tax revenues every year on a "pay-as-you-go" basis. The government simply pays out what is owing to seniors who apply for OAS and GIS pensions. Applicants must apply no later than six months before they are eligible to receive benefits at age 65.

To qualify for OAS, applicants must have lived in Canada for at least ten years after age 18, or for at least ten years before taking one's OAS pension at age 65. Those who fall short of forty years of residence in Canada are eligible for a reduced OAS pension. Currently, over 4.5 million seniors collect OAS. It is the single largest program funded by the federal government (costing an estimated \$36.2 billion for 2009-2010).

As of July to September 2009, the maximum OAS pension for single seniors was \$516.96 per month. Currently, OAS benefits are gradually clawed back for seniors who earn over \$66,335 per year, but 95% of current seniors fall below this mark. For that reason, OAS is regarded as an almost universal pension plan. The present average OAS benefit is \$489.54 per month.

The GIS was introduced in 1967 closely following the introduction of the CPP in 1966. At that time, it was recognized that few Canadians near retirement would accumulate much in CPP benefits, so a temporary and targeted program for low income seniors was needed. It aimed to offer a boost for poor seniors to supplement their OAS and CPP benefits. The GIS and OAS in tandem provide what amounts to close to a flat rate minimum income to all Canadian seniors.

Since its introduction in 1967, the GIS has been hardly temporary. Today, 35% of seniors who apply for the OAS also qualify for GIS benefits, which means (as of 2009) they have incomes of less than \$15,672 per year (or \$1,306 per month).

Currently, over 1.6 million seniors collect the GIS. The maximum benefit for individuals is \$652.51, or \$430.91 for each spouse. Even maximum benefits in combination with the OAS fall below the poverty (or low income) line, especially in larger urban

centres. In 2007, the LICO line in a large urban centre was \$17,219 for singles, and \$20,596 for couples. While the poverty rate for senior couples in Canada is low (less than 2% in 2006), 16.1% of single women seniors and 14.0% of single senior men lived in poverty in 2006.

The present average GIS monthly benefit for singles is \$452.61 a month.

Table 4 shows the average OAS/GIS benefits (as of July to September 2009). While these program provide a bare-bones income, they fall short of what is needed to provide a decent retirement income for those without other CPP or private pension income or savings.

Recipient(s)	OAS	GIS	Total OAS/GIS average benefits
Single	\$489.54 per month	\$452.61 per month	\$942.15 per month / \$11,305.80 per year
Member of a couple (both are pensioners)	\$430.90 per month, each	\$283.21 per month, each	\$714.11 per month / \$8,569.32 per year, each person

For decades, Canada received praise for reducing poverty through OAS/GIS, but more needs to be done to close the poverty gap, especially in larger urban centres.

How it would work

We propose an increase in the GIS benefit rate to eliminate poverty among low income seniors. The immediate annual cost of this measure is \$682 million on top of the current \$8-billion annual cost of the GIS. This cost could be met by trimming back very modestly the high limits on RRSP contributions.

3. Protecting Canadian pensions through a federal system of pension insurance

Summary

In many advanced industrial countries like Canada, pensions are protected through various forms of mandatory insurance. Mandatory pension insurance (paid for by pension funds themselves) is a fair trade-off for the tax-exempt status governments afford pensions in the first place. Its primary role is to insure pension benefits for workers in the event a fund is unable to meet its obligations on wind-up. A pension insurance system could also play an important role administering the assets of stranded pension plans. Pension insurance would offer workers and retirees a base floor of pension security in tough economic times.

At the onset, this system would only cover federally regulated pension plans, but the federal government should enter into negotiations with the provinces to create a national system.

Why we need it

Mandatory insurance is required for most of the important assets Canadians have. We are required to insure our vehicles, our homes, and even our jobs – employers must pay into Employment Insurance and Workers' Compensation to operate. Mandatory insurance exists because some things are critical to protect.

This same rationale created the Canadian Deposit Insurance Corporation in 1967 which offers \$100,000 in protection for bank deposits. Since 1967, forty-three Canadian financial institutions have failed, and all were members of the CDIC. In each instance, the CDIC afforded Canadians financial security when they needed it most.

Unfortunately, most Canadians are not protected by mandatory pension insurance, and we see the consequences of this in today's challenging economic times. As one business commentator has explained:

In January of 2009, 567 firms pulled the plug on their operations and filed for bankruptcy. Ontario manufacturing bankruptcies also rose 24%. Business insolvencies rose severely in Quebec, where the recession is strongly hitting the province's industrial sector. 250 companies closed their doors in January, up from 202 closures in December of 2008.

These grim realities have been all too common in recent months. A crisis, which began on Wall Street and Bay Street, seized credit markets and accelerated an already fast-growing rate of business failures in key sectors. This has put the private pensions of many Canadians in serious jeopardy. Most plans are

now significantly underfunded to the tune of 25% to 30% due to low interest rates (which increases liabilities) and falling share values which have undermined plan assets. While most large plans can solve these funding problems over time, underfunding is a very serious issue if an employer goes under.

Now, more than ever, all Canadians need a base floor of insurance to protect their hard-earned pensions. They need a pension insurance system that can help employers with no prospects of recovery, and others who only need temporary help.

The only region in Canada that currently insures pensions is Ontario, where a mandatory fund has existed since 1980 protecting pensions to a maximum of \$1,000 per month (or \$12,000 per year). An Expert Commission recently recommended this amount be increased to \$2,500 to address the cost of inflation since. We propose this same amount of protection.

How it would work

The pension insurance system we propose would have two components:

1. An agency to adopt abandoned pensions when an employer shuts down permanently; and
2. A fund that insures a base floor of pension benefits when an employer restructures during bankruptcy proceedings and is unable to make good a solvency deficit.

In the first component, the federal government – following the recent lead taken by the Government of Quebec – would create

an agency to adopt abandoned pension plans when employers terminate their operations. This agency would be housed in the federal financial regulator of pension plans, the Office of the Superintendent of Financial Institutions (OSFI).

This agency would ensure workers get the estimated value of their pension plan when an employer terminates. If, for example, a pension plan is 75% funded going into an employer bankruptcy, this agency would assume operation of the pension fund, and guarantee workers and retirees a 75% benefit. It would also invest the funds to attempt to improve on this amount, ultimately to try to bring it back to solvency. A fund manager should be able to secure a better pension than would be possible if annuities were immediately purchased.

The second component of this pension insurance system would offer a base floor of \$2,500 in pension benefits per month when an employer enters bankruptcy proceedings with a large solvency deficit which cannot be made good. Regulators at OSFI would be responsible to oversee all claims to ensure none are fraudulent (that the system isn't being used to offload pension obligations).

At its core, this ongoing and mandatory pension insurance system would be financed by levies from pension plans themselves. The fee structure would be based on Ontario's system, with an increase to finance the maximum amount recently proposed by the Ontario Expert Commission on Pensions. It would assess a mandatory fee of \$2.50 per plan member for pensions that are well funded, and higher premiums for plans with poorer funding records (to a maximum of \$12.5 million per year).

This core funding system would be suitable in most cases, but studies suggest a larger reserve fund is also necessary for larger claims. The recent experience of General Motors testifies to the need for this additional protection.

A reserve fund could be financed by a small 0.1% financial transfer tax on Canadian stock markets. This tax would be levied by the pan-Canadian securities regulator the federal government plans to introduce soon. The tax would have minimal impact on long-term holders of shares, but would hit the same speculators who have caused the current financial crisis and force them to play a role in protecting Canadian pensions.

The need for such accountability is clear. Research suggests that 95% of trading on stock markets are speculative bets on the rise and fall of prices for various stocks and bonds. This frantic paper shuffle creates no real wealth for Canada's economy, but it exposes pension funds to the inevitable moment when the value of the market collapses. Canada should follow the lead of thirteen other nations who use a financial transfer tax to extract a rent on speculators. Such a tax would have generated a fund of \$7 billion from the Toronto Stock Exchange alone in 2007 (not taking into account the impact of a tax on the volumes of transactions).

Conclusion

One of many reports commissioned on Canadian pensions was written in 1983 by the Parliamentary Task Force on Pension Reform, and it proposed several standards for the "voluntary," fend-for-yourself wing of the Canadian pension system. The report was clear about what needed to happen if these standards weren't met:

We have...made difficult judgements and hard choices in order to set targets and suggest guidelines. Indeed, we pose several specific challenges to employers. If they cannot meet them, we see no alternative to substantial expansion in the scale of public plans for providing retirement income.

Though it is said all too often, Canadian pensions are truly again at a crossroads. Where we go next depends on the pension values that influence our decision-makers.

It is now Ottawa's turn to answer an age-old question in pension policy: do we move forward together, or will the government ask everyone to fend for themselves?

In recent decades, the second set of values has won out on Parliament Hill, though this hasn't always been true. The Canada Pension Plan, Old Age Security, and adequate workplace pensions are a reminder of what's possible when Canadians move forward together.

If we bring the values of our universal Medicare system to Canadian pensions, the policy answers are obvious.

After a lifetime of work, all Canadians deserve security and dignity in their retirement years.

We must expand the CPP and improve OAS/GIS to ensure no one gets left behind, particularly in an economic crisis.