Retirement income security

INTRODUCTION

Canadians deserve dignity and security in retirement. Statistics Canada estimates that 12 per cent of senior families are considered low income and 28.5 per cent of single seniors qualify as low income. That's 600,000 Canadian seniors living in poverty.

Pension plan coverage has declined, with about 37.1 per cent — or 6.3 million Canadians — covered by any kind of registered retirement plan in 2018. Defined benefit plan coverage has decreased significantly in the private sector, moving from 21.9 per cent in 1997 to 9.2 per cent in 2017. Household savings rates are the lowest they have been in modern memory, and household debt continues to soar. Canadians are increasingly relying on the Canada Pension Plan and Old Age Security to support their retirement.

Healthy retirement pensions affect economies, too. Canadian pension plans invest in Canadian equities, real estate and infrastructure such as roads, bridges, railways, airports, utilities, and pipelines. The market value of pension plans in Canada in 2018 was $1.97 trillion (Benefits Canada, 2019). Retirees continue to make significant purchases, including cars and new housing. Many travel domestically, engage in other recreational pursuits and volunteer (over 1 billion hours by baby boomers and older adults in 2010) — all activities that are important to Canada's economy.

It's time to prioritize retirement income security by developing a strong policy environment that:

- Encourages well-managed defined benefit pension plans and enables retirees to continue to contribute to a strong economy;
- Rejects legislation that allows employers to walk away from their pension promises;
- Plans for ongoing enhancements to the Canada Pension Plan to ensure that those who do not have a workplace pension plan are able to save enough for retirement;
- Strategically increases the Guaranteed Income Supplement to lift the most vulnerable seniors out of poverty;
- Prioritizes employees and retirees in bankruptcy, so that all Canadians can retire in dignity; and
- Repairs issues with the federal public sector pension plans while addressing concerns with the Phoenix pay system — to help mend the relationship between the government and current and former public servants and veterans.

RECOMMENDATIONS

1. Ensure a policy environment that protects and strengthens well-managed defined benefit pensions and repudiates legislation that allows plan sponsors to abandon their legal requirement to fund defined benefit pensions.

<u>Defined benefit pensions are efficient and effective</u>

David Dodge, former governor of the Bank of Canada, noted that "defined-benefit plans have important positive attributes for economic efficiency, allowing for a better allocation of savings. But there are also efficiency gains for financial markets. The managers of defined-benefit pension plans have both the ability and desire to invest in the kinds of assets that the average individual investor might not normally consider."[1]

Canadians – particularly younger Canadians – want good pensions that enable them to maintain their standard of living in retirement. According to research from 2017, 91 per cent of Canadians are willing to contribute more of their income for features associated with modern defined benefit plans, like predictable retirement income that is guaranteed for life. But too many Canadians are worried because they don't have the strategies, tools, or confidence to make that can happen.

Defined benefit plans are more efficient.[2] Hugh Mackenzie's 2014 study "Risky Business" concluded that a Canadian who contributes a regular percentage of their income to

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retirement savings (through RRSPs, TFSAs or PRPPs) over their lifetime would pay on average 2.07 per cent annually in investment management fees — or 36 per cent of their savings over a lifetime.[3]

There is a false perception that defined benefits are too costly or unsustainable. In fact, defined benefit plans are the most effective means of generating retirement security. Studies by the National Institute on Retirement Security in the U.S. show that defined benefit plans can deliver the same retirement income at a cost 48 per cent lower than the cost of a defined contribution plan over the long term, due to lower fees, a balanced investment portfolio and longevity risk protection. Defined contribution plans are subject to short-term market fluctuations. When an individual with a defined contribution plan retires, their retirement fund's value is determined by the whims of the current market and their ultimate income stream depends on how well they invest their "pension pot".[4]

Retirees with defined benefit plans are less likely to rely on government assistance such as the Guaranteed Income Supplement. In fact, defined benefit pensions reduce the annual GIS payout by $2-3 billion each year.[5] And solid retirement income security brings with it better health status and outcomes, which helps to contain demands on the health care system.

<u>Preventing Conversion of Accrued Benefits to Target Benefits</u>

Unfortunately, defined benefit plans have been under attack in recent years. In October 2016, Bill C-27 was introduced, which would have allowed Crown corporations and federally regulated employers to change good defined benefit pension plans into target benefit pension plans.

Target benefit pension plans, or "shared risk" plans, are often seen as a middle ground between defined benefit plans, which offer a guaranteed pension, and defined contribution plans, which provide a lump sum amount based on investments. Target benefit plans are not in and of themselves a problem. The problem arises when governments enact legislation that allows plan sponsors to convert earned or accrued defined benefit pensions into target benefit pensions.

Target benefit plans provide targets; the pensions paid out under target plans depend on plan performance. All the risk is transferred to employees and retirees. In tough times, pensions under a target benefit plan can be reduced, providing less retirement security for its members and making it tougher for older adults' incomes to keep up with the cost of things like inflation.

When employers promise current employees and retirees defined benefit pensions as part of their compensation, these pensions are a form of deferred wages. We believe a deal is a deal and employers should not be able to take back compensation they promised to their employees or retirees.

Happily, Bill C-27 did not become law – it languished on the order paper for nearly three years and then died when the 2019 federal election was called. But Bill C-27 and legislation like threaten to erode defined benefit plans and Canadians' retirement security. This government must repudiate legislation that allows defined benefit plan sponsors to push employees and retirees to surrender or unilaterally reduce benefits that were promised and earned.

The federal government must work with provincial governments and public sector pension plans to find innovative solutions for distressed defined benefit plans, such as the transfer of assets and liabilities to large, securely-funded public sector plans (if members, unions and trustees agree to do so, and if the plan structure permits it). Positive examples of this kind of innovation in Ontario have been offered by the OPSEU Pension Trust (OPTrust) and the Colleges of Applied Arts and Technology (CAAT) Pension Plan. They have created career-average defined benefit plan options that are available to employers in the not-for-profit and private sectors, giving employers and employees access to expertise, scale and better retirement security. Mergers that exist simply to reduce benefits should be opposed, but in certain circumstances, and with solid regulatory oversight, these innovative models for delivering defined benefit pensions could improve Canadians' retirement security.

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2. Lift vulnerable older adults out of poverty — and keep them there — by protecting and enhancing the Guaranteed Income Supplement (GIS) and Old Age Security (OAS).

OAS provides a basic level of retirement income to all Canadians (subject to residency requirements), while the GIS provides additional support for low-income seniors and their spouses. These programs have become more necessary as retirement savings programs have continued to dwindle; they are most valued by low and modest earners.

The current government's plan to increase OAS by 10 per cent for seniors over the age of 75 is a step in the right direction. Attention also should be turned to the GIS. In many cities across Canada, the maximum combined monthly OAS and GIS payments are less than the average cost of rent. GIS should be strategically increased to ensure that the lowest income earners can continue to live in dignity.

While many older adults continue to find meaning and contribute with paid work, many GIS recipients are forced to return to the workforce for financial reasons. While we understand the need for the OAS recovery tax aimed at higher income earners, it is frustrating for those low-income earners who are forced to return to work to find themselves penalized by a reduction in their GIS.

GIS recipients can earn up to $3,500 of employment income without affecting their GIS. However, if they earn more, their GIS is reduced by 50 per cent of excess earnings. Thankfully, the 2019 budget included provisions to increase the sums exempt up to $5,000 and an additional 50 per cent of the next $10,000 earned. While we applaud this decision, we do recommend that these sums should be calculated with indexation in mind – $5,000 in 2020 will not be worth the same as $5,000 in 2030.

Finally, there are seniors falling through the gaps because of process. Every year, some seniors who qualify for the GIS will not receive it, or will see their benefits paused for months, because they filed their income taxes late. Late income tax filing can occur among older adults for any number of reasons, including physical and mental health issues and coping with the death of a loved one. The months when these individuals are deprived of their GIS payments can be incredibly difficult. In 2019, Bill C-449, an Act to Amend the Old Age Security Act (monthly guaranteed income supplement) was introduced. It sought to give seniors who receive GIS a one-year grace period to get their taxes completed before stopping payments. Unfortunately, the legislation died on the order paper when the 2019 federal election was called. We recommend that the provisions in this bill be adopted in new legislation by this Parliament.

3. Expand the Canada Pension Plan

The Canada Pension Plan (CPP) is sustainable for at least the next 75 years, according to Canada's Chief Actuary. In fact, the plan's assets are valued at $400.6 billion[6] and its investments are expected to reach $500-billion by 2024. Approximately $54 billion of these investments, or 20 per cent of the total, is invested in the Canadian market — everything from major infrastructure projects to real estate to natural resources to local companies. The CPP is not only viable — it is integral to our economy.

There are 5.8 million CPP beneficiaries; retirement and disability pensions paid over $44.5 billion in 2018. The maximum monthly payment an individual receives is supposed to represent a 25 per cent replacement rate (33 per cent once the new expansion is fully implemented in 2023 – with contributions increasing from 4.95 per cent to 5.95 per cent). It is a strong pillar of Canadians' retirement plans.

With the decline in employer-based pension plan coverage and new challenges facing those in the workforce, such as precarious employment, more people are turning to public options as their main source of revenue in retirement – but it's not going to be enough.

The maximum CPP retirement pension (starting at age 65) in 2020 was $1,175.83/month. However, only 6 per cent of retirees actually receive the maximum amount. The average CPP retirement pension in October 2019 was only $672.87/month — $443.37 for survivors younger than 65 and only $304.43 (on average) for survivors over 65 (mostly women).

The recent expansion to the CPP was a step in the right direction. But if the number of Canadians covered by defined

benefit or other adequate plans continues to decline, Canadians will need the federal, provincial and territorial governments to work together to continue to enhance the CPP.

Several different options could accomplish this. The federal, provincial and territorial governments' recent enhancements will see the CPP's target income replacement rate increase from 25 per cent to 33 per cent once they're fully implemented. This government should commit to a measured approach to ensure the CPP will continue to meet Canadians' retirement needs and goals, which may include further increases to the income replacement target.

4. Continue to deliver well-funded, sustainable federal public sector pensions, and address such issues as proper compensation for Phoenix pay system errors and the mending of certain features of federal public servant retiree and veteran compensation.

It is not uncommon to hear calls for public sector pensions to be significantly reduced in the face of lower defined benefit plan coverage in the private sector.

It shouldn't be a race to the bottom.

Retirement income security for one group doesn't come at the expense of another. Ensuring all Canadians have the means to afford a healthy and secure retirement needs to be a priority.

Public sector pensioners are substantial contributors to the economy. Up to 80 per cent of all pension dollars spent come from investment returns which are then pumped right back into local economies.

In May 2018, the National Conference on Public Employee Retirement Systems (NCPERS) in the United States published "Unintended Consequences: How Scaling Back Public Pensions Puts Government Revenues at Risk".[7] The researchers wanted to know how public sector defined benefit pensions and the investment of pension assets affect state and local economies and revenue generation. Drawing on historical data, they found that for every $1,000 invested, $1,088 was returned into the economy.

That may not seem like much, but when you're talking about $3.7 trillion in pension fund assets in the U.S., the dollars and cents add up quickly. NCPERS also found that, in 2016, public pension funds generated $137.3 billion more in revenues than taxpayers contributed to those plans. "Taxpayers cannot afford continued assaults on public pensions," the researchers concluded. While this is American research, parallels can be drawn to the Canadian context.

Pension plans have the funds and the long-term vision required to make large investments in important infrastructure projects, real estate, natural resources and local companies. For instance, PSP Investments has invested a small part of the $4 billion the plan has invested in Canadian real estate alone in Canadian seniors' retirement communities.[8] The Caisse de dépôt et placement du Québec (CDPQ) — which manages 41 pension funds in Quebec, including the pension plans of hundreds of thousands of public sector employees — has made several investments in Canadian companies, infrastructure and real estate, from hotels to airports to wind farms and public transit systems. The Ontario Teachers' Pension Fund has over 44 per cent of its funds invested in Canada.[9]

Public sector pension plans are not financial drains that drag down the economy. They are sources of revenue and investment. Federal public sector pensions are also great tools for retaining and attracting talent in the public service. After all, these are the folks who serve Canadians in many important capacities, and who will help to ensure that Canada continues to have the most effective public service in the world.[10]

We recommend that the federal government remain committed to delivering well-funded, sustainable public sector pension plans. Overall, federal public service pension plans are working as intended. Some improvements are recommended, however.

The first improvement would address a gap that emerged following recent changes to the federal public service pension plan. In 2012, employees were divided into two groups under the pension plan – those who joined the public service prior to January 2013 and those who joined after. The plan provisions are different for those who joined after

2013; for example, people who joined the public service after 2013 have a higher retirement age and different contribution rates. Veterans who are hired into the federal public service and transfer their pensionable military service to the public service pension plan after 2013 are subject to the later retirement date, even though they served Canada prior to the cut-off date. This issue of fundamental fairness can easily be resolved for the women and men who served Canada in the Armed Forces, and who continue to serve the country as part of our public service.

The second issue concerns retired public servants and veterans (also referred to as "plan members") in common-law relationships who want to make sure that their survivors are eligible for survivor pensions. Under current legislation, if couples establish their relationship (whether common law or married) prior to the retirement[11] of the plan member, and remain in that relationship until the plan member's death, the spouse is eligible for survivor benefits. However, federal public sector pension administrators maintain that a common-law spouse's eligibility for survivor benefits can be ascertained only at the time of the plan member's death. If the plan member and their spouse were married, they can be assured by the pension administration, prior to the death of the plan member, that the spouse will receive survivor benefits. Those who are in common-law relationships must wait until the plan member is deceased, then build a case with evidence that their relationship existed prior to retirement and hope that they qualify for survivor benefits.

The Public Service Superannuation Act (PSSA), Canadian Forces Superannuation Act (CFSA) and Royal Canadian Mounted Police Superannuation Act (RCMPSA) specify that the pension administration must establish that an individual was "cohabiting in a relationship of a conjugal nature with the contributor for at least one year immediately before the death of the contributor" in order for the surviving spouse to be eligible for the survivor pension. This provision does not prevent the pension administrator from confirming survivor pension eligibility for plan members in common-law relationships prior to the death of the plan member. This unequitable treatment of common-law relationships appears outdated and can be swiftly remedied by the federal government.

Finally, a resolution is urgently needed for the tens of thousands of employees and retirees who continue to be affected by the Phoenix pay system, which has damaged public servants' trust in the administration of their pay and compensation.

In a survey of Federal Retirees members, 42 per cent of those who had retired in the past three years said they had been affected by Phoenix is some way — everything from significantly long waits for severance pay to situations where individuals now owe the government substantial sums because they never stopped being paid. This pay system has created untold amounts of stress and anxiety for both federal retirees and current public servants; 74 per cent of public servants have indicated that their pay has been affected in some way by Phoenix. The system needs to be repaired or replaced as soon as possible – and the government should consider compensation above and beyond the agreements it already has negotiated with some unions.

CONCLUSION

The current government's commitment to retirement security was part of its election platform and its messaging during the previous mandate. It is now time to carry that momentum forward — by building a strong policy environment and encouraging innovation to ensure defined benefit and public pension plans across sectors and industries continue to thrive, grow and contribute to Canada's economy, and through strategic protections for pensioners, including targeted increases to the Guaranteed Income Supplement to lift the most vulnerable seniors out of poverty.

1 Dodge, D. (2005, November). Economic and Financial Efficiency: The Importance of Pension Plans. Retrieved from Bank of Canada: https://www.bankofcanada.ca/2005/11/economic-financial-efficiency-importance-pension-plans/

2 According to the Association of Canadian Pension Management, "pension record keepers estimate that about 80 per cent to 90 per cent of all Canadian retirement savings held outside of DB pension plans will be turned into retirement income through individual plans. It has been suggested that high costs, poor decisions and conflicted advice will produce [Canadian Accumulation Plan] retirement incomes about 20 per cent to 30 per cent less than they could be if institutional fees, smart defaults and fiduciary oversight were applied." (Association of Canadian Pension Management, 2017)

3 MacKenzie, H. (2014). Risky Business : Canada's Retirement Income System. Toronto: Canadian Centre for Policy Alternatives.

4 Rhee, W. B. (2014). Still a Better Bang for the Buck : An Update on the Economic Efficiencies of Defined Benefit Plans. Washington: National Institute on Retirement.

5 OPTrust. (2013). New analysis confirms that defined benefit pensions provide significant benefits to Canadian economy. Toronto: OPTrust.

6 CPP Investment Board. (2019). Sustainability of the CPP. Retrieved from CPP Investment Board: https://www.cppib.com/en/our-performance/cpp-sustainability/

7 National Conference on Public Employee Retirement Systems. (2018). Unintended Consequences: How Scaling Back Public Pensions Puts Government Revenues at Risk. Washington: National Conference on Public Employee Retirement Systems.

8 PSP Investments. (2019). 2019 Annual Report. Ottawa: PSP Investments.

9 Ontario Teachers' Pension Plan. (2018). 2018 Annual Report : All The Right Elements. Toronto: Ontario Teachers' Pension Plan.

10 InCiSE. (2017). The International Civil Service Effectiveness (InCiSE) Index, 2017. Oxford, England: InCiSE.

11 Or, for plan members of the Canadian Armed Forces and Royal Canadian Mounted Police plans, prior to the plan member attaining age 60.

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