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"PENSION COVERAGE IN CANADA: A LOOMING CRISIS"

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List of Abbreviations

AIW:	Average Industrial Wage (about $32,000 in 1992)
CPI:	Consumer Price Index, the principal measure of inflation in Canada
CPP:	Canada Pension Plan
C/QPP:	Canada and Quebec Pension Plans (which are virtually identical and provide for full transferability between each other)
GIS:	Guaranteed Income Supplements
OAS:	Old Age Security
QPP:	Quebec Pension Plan
RRSP:	Registered Retirement Savings Plan. The IRA in the United States was modelled on this Plan.

Currency

All monetary amounts are shown in Canadian dollars unless otherwise indicated. Sample exchange rates at January 10, 1992: *$1 Canadian:*

U.S. Dollar	-	0.87
British Pound	-	0.48
German Mark	-	1.37
Japanese Yen	-	110.17
French Franc	-	4.67
Italian Lira	-	1,034.13

1. Purpose

1.01 The subject of this paper almost certainly has relevance in many other countries, indeed many of the symptoms are likely much the same. This paper is therefore not intended to identify a problem unique to Canada. The purpose of this paper is to try to stimulate discussion of potential solutions.

1.02 In discussing potential solutions it is, of course, important to clearly identify the problem and to place it in a proper context. Accordingly, this paper will:

1. Provide some historical perspective on the Canadian pensions scene.
2. Discuss where developments have landed us today.
3. Briefly review some potential solutions to the coverage problem.

1.03 It is worth doing this in the context of the famous three-legged stool. This describes the concept that retirement income should and does come from three main sources - government plans, employer sponsored plans, individual plans. While this concept may eventually disappear, it will continue to be relevant over the next 20-30 years, the period over which Canada's retirement income problems will reach their peak.

2. Historical Perspective

2.01 The pension system as we know it today in Canada has really developed over the last 40 years. In 1952, Old Age Security (OAS) was enacted by the federal parliament. This is a flat benefit program available to all Canadians on attaining age 65, subject to certain residency requirements. Benefits, which are fully indexed, are simply paid out of general tax revenues and equate to about 15% of the Average Industrial Wage (AIW).

2.02 OAS was followed, in 1957, by the introduction of RRSPs, (Registered Retirement Savings Plans). These allow individuals to contribute tax deductible amounts to approved savings plans, in which investment earnings are tax sheltered. Payments from the plan, to commence no later than age 71, are included in taxable income.

2.03 In 1966, the Canada and Quebec Pension Plans (C/QPP) were introduced. These are employment earnings-related plans, to which both employers and employees contribute on earnings up to the AIW. They are virtually identical and "funded" on a modified pay-as-you-go basis. The C/QPP provides at age 65 fully indexed pensions of about 25% of final average earnings up to the AIW.

2.04 The federal Guaranteed Income Supplements (GIS) were introduced about the same time as C/QPP and payments commenced January 1, 1967. This is a system of income-tested payments to people age 65 or over, and was intended to be a short-term measure which would virtually disappear as the C/QPP grew and matured. We'll come back to that later on.

2.05 The first pension standards legislation, covering standards of vesting, funding, investments, etc. for employer sponsored plans, became effective January 1, 1965 with the passage of Ontario's Pension Benefits Act. This was rapidly followed by very similar (i.e., almost identical) Acts in Québec, Alberta and Saskatchewan. In 1967 the federal government also passed the Pension Benefits Standards Act covering federally regulated organizations and employees. Similar legislation was passed in the 1970s by Manitoba and Nova Scotia.

2.06 What Canada had through this period up to the 1980s was a system that, while not perfect, worked reasonably well. RRSPs provided strong incentives for individuals to save for retirement; the C/QPP, OAS, GIS combination provided a reasonable safety net; and company sponsored plans flourished and were strengthened by legislation that was reasonable, virtually uniform across the country and applied in a pragmatic and sensible way. The three-legged stool of retirement income (government/employer/individual plans) was significantly strengthened.

2.07 Unfortunately, this structure came under attack largely because of the rampant and historically high inflation that confronted Canada in the 1970s and early 1980s. (See Appendix.) Inflation redistributed income from those (like retirees and deferred vested members) who had no or limited protection against inflation to those whose incomes were reasonably protected against inflation. Individual RRSPs, typically conservatively invested, also had a hard time maintaining real value against the ravages of inflation. Accelerating inflation also depressed asset values at a time when salaries and wages and, therefore, pension liabilities were being rapidly pushed up by inflation. During the 1970s, this resulted in large unfunded liabilities in private pension plans and large increases in contributions required to fund them.

2.08 Other problems also emerged and were exacerbated by inflation, not the least of these being the plight of widows whose husbands had left them little in the way of pension. What protection they did have (other than government schemes) was being eaten away by inflation. Furthermore, despite the introduction of "portable pensions" legislation in the '60s and '70s, too many people were still leaving pension plans with little or no benefit other than their own contributions accumulated with nominal interest. The deferred vested member also ranked lowest on the agenda of companies and unions when it came to negotiating or implementing pension improvements. But, most importantly, there were still not enough people covered by private pension plans. One leg of the three-legged stool was not doing the job, which put an increasing strain on the other legs, particularly government plans.

2.09 The result was a flurry of major studies and reports culminating in 1981 with the publication of the Report of the Royal Commission on the Status of Pensions in Ontario. The federal government also convened the National Pensions Conference in 1981, a major and significant conference involving representatives of virtually every group with an interest in Canada's pension system. The conference was called to discuss the *private* pension system, but it is pretty well impossible to talk about the private pension system without putting it in the context of the total system.

2.10 There were four major topics covered by the conference, and, not surprisingly, they were: (a) Coverage; (b) Women and pensions; (c) Protection against inflation; and (d) Portability, vesting and locking-in. ("Locking-in" prevents pension monies, including those transferred to RRSPs, from being paid out other than in the form of a life, or joint and last survivor, annuity).

2.11 A fair amount of consensus emerged as to *what* needed to be done, but the "how" was left hanging. That proved to be a mistake. What we saw in Canada during the 1980s was a horrendous torrent of legislation, regulation, and, at least in some jurisdictions, totally non-pragmatic administration of the regulations. The legislation itself has been confused and misguided, not really identifying whether it is intended to be a proxy for social insurance or a definition of the rules of the game in a voluntary system. The deferred compensation concept with its logical conclusion of money purchase plans has been given paramountcy by legislators and others, while these very same people promote defined benefit plans as being socially desirable.

2.12 Legislation governing pension plans which, until 1981, was reasonably uniform has now become a chequer board of different rules across the country. 1981 was the year Saskatchewan made significant changes to its legislation. Since then uniformity of legislation has become a pipedream.

2.13 While all of this was going on, the tax rules governing retirement income plans and savings were significantly changed. This, supposedly, put RRSPs and other money purchase plans on the same footing as defined benefit pension plans. However, in light of the hostile regulatory environment surrounding defined benefit pension plans, the new rules have made RRSPs and money purchase plans much more attractive. This makes little sense when the defined benefit plan is clearly seen as the more desirable vehicle for social policy and other reasons, something that both business and organized labour in Canada appear to agree upon, as well as government.

3. Where Are We Now in Canada?

3.01 Thus, *we still have major problems with our retirement income system*. For example, in a survey of *private sector* plans, carried out in 1990, while it was found that 75% of the plans covering 96% of the members had at some time in the past provided increases for retirees, typically these averaged in the range of only 25-50% of the CPI increases. The same survey indicated that only 9% of plans covering 5% of members provided any increase in benefit for deferred vested members during the period of deferral. Thus, while we may have stronger vesting, locking-in and *transferability* rules, it is difficult to conclude that we have real *portability*.

3.02 But even if we had better inflation protection and better portability, these are only of value to those covered by employer plans. And that's where the story is saddest. According to Statistics Canada, 47.7% of employed paid workers were covered by employer pension plans in 1980, but only 44.8% in 1990 (or only 37.6% of the total labour force), and the trend line is clearly downward. With respect to women, only 37.6% of female employed paid workers were covered in 1980 and this had edged up marginally to 39% in 1990. Only 25.1% of male part-timers and 23.2% of female part-timers were covered in 1989. Furthermore, in 1980, 8.3% of plan members in the private sector were covered by money purchase plans, but by 1990 this figure had climbed to 13.3%. One leg of the three-legged stool is clearly in need of strengthening.

3.03 But what about the other two legs, individual plans and government plans? With respect to individuals, it is probably worth looking at RRSP statistics. These tend to be a little vague, but, based on information gathered from sources such as Statistics Canada and the insurance industry, it appears there were approximately 2 million RRSP owners in 1980, with total funds of roughly $22 billion. These figures had increased to approximately 4 million contributors with $120 billion in assets in 1989.

3.04 Furthermore, there has been a clear shift in annual contributions from pension plans to RRSPs. Statistics Canada figures show that the split between (a) total employer and employee contributions to employer sponsored plans, and (b) contributions to RRSPs, was roughly 70%/30% in 1979, but by 1989 this had shifted to 55%/45%. This shift is expected to continue. This, too, is not healthy since employees are far more exposed to risk under RRSPs than under defined benefit pension plans. This will inevitably lead to big losers (as well as big winners), which in turn will increase the need for government assistance through plans such as the GIS.

3.05 Projections suggest future growth to 7 million RRSP contributors in 1999, with $500 billion of funds. This represents an average of just over $70,000 per RRSP owner, or $47,000 in 1991 dollars. It is worth putting this in the context of the fact that we can expect about 13 million contributors to the C/QPP by the turn of the century.

3.06 All of this (i.e., falling pension coverage and poor quality coverage, only 7 million RRSP contributors out of 13 million C/QPP contributors, the shift in contributions from defined benefit pension plans to RRSPs, and the average RRSP amount being relatively small) suggests that there will still be a strong dependency on the third leg of our stool, namely government. But government programs are also in a weak position, largely due to the well documented phenomenon of an aging population.

3.07 CPP contributions are already legislated to increase to a level of 10.1% by 2016 (from 4.6% in 1991). This is 5.05% of contributory earnings from each of the employee and employer. The latest actuarial report on the CPP suggests that this 10.1% figure will need to increase to in the order of 12% only 10 years after that and 13% by the year 2035. (Similar figures would apply in Québec.) OAS costs will also climb, according to the federal government actuaries, from the equivalent of 3.5% of *total* employment earnings in Canada to 4.5% by the year 2025. All of this is without any change in benefits.

3.08 And while GIS was intended to be a *temporary* measure to cover the gaps while the C/QPP matured over the first 10 years of their life, 25 years later the number of GIS recipients is still over 40% of OAS recipients. Annual GIS payments, currently amounting to about $4 billion, compare with about $13 billion being paid from OAS. This is a clear indication of significant weakness in our current system.

4. <u>Potential Solutions</u>

4.01 Let us, then, briefly discuss some of the potential solutions and, again, do this in the context of our three-legged stool.

4.02 (1) <u>Expand the C/QPP</u>. Expanding the C\QPP is seen by labour as the simple solution. Increase the benefit level to 75%, and there is no need to worry about private plans and RRSPs with all their faults or complexities. Those earning in excess of the average industrial wage could still reach the 75% level through RRSPs or supplementary pension plans, but the bulk of the population would be well looked after. Nagging issues like surplus ownership would lose their significance. Full portability and inflation protection would be achieved.

4.03 It's clearly a simple solution, but with one major problem. Who pays? If providing a pension of 25% of final average pensionable earnings (the current C/QPP benefit) is going to require contributions in the 12-13% range within the next 35 years, increasing the benefit to 75% will require contributions of 35-40% of contributory earnings. Can we really expect our children and grandchildren to carry such an enormous burden?

4.04 In the U.S. we saw Social Security being cut back in various small but important ways during the 1980s. Not the least of these is the gradual increase in the eligibility age. Studies have shown that increasing the age eligibility for C/QPP could significantly reduce future contribution rates. And perhaps that's the clue to another possible solution.

4.05 (2) Modify the C/QPP. Why not increase the C/QPP benefit level, at the same time as increasing the age for retirement benefits? Presumably we would want to do something similar with OAS and GIS, though our objective should be to minimize the need for welfare (GIS). The problem with this is that we may find ourselves needing to increase the retirement age *in any event* because we will not be able to afford C/QPP, OAS and GIS in the future, or because future generations will refuse to accept such heavy burdens.

4.06 (3) Increase OAS and/or GIS. Since OAS and GIS are paid directly out of tax revenues, rather than from a C/QPP-type "fund" to which employees and employers contribute, increasing them may be easier to do politically, especially if we increase the OAS "claw back" feature. This feature results in OAS benefits being significantly diminished or eliminated if individual income exceeds a certain threshold. This threshold started at $50,000 in 1989 and is indexed to increases in the CPI less 3% p.a. (However, if we really want to claw back OAS, why not roll it straight into the GIS system? But then we are not minimizing the need for GIS.)

4.07 Since OAS is a universal non-employment-related program, increasing it would provide more coverage for people like home-makers. Many in Canada argue that these people (still typically women) provide economic value and should be given increased pension coverage. OAS already covers them. The problem, again, is the imposition of unacceptable costs on future generations. Future generations are more likely to attack programs like OAS than the C/QPP because their parents and grandparents will not be seen to have contributed to the OAS.

4.08 The basic problem with increasing or expanding government programs always comes back to the potentially unacceptable burden we are placing on future generations. This leads us to the need to find a way properly to fund our retirement income programs, which forces us to look at the other two legs of our three-legged stool, employer pension plans and individual savings - usually RRSPs.

4.09 (4) Union Run Plans. Looking at pension plans, one option some labour proponents are now advocating in Canada is union run plans. The argument is made that, since employers now have few incentives to maintain or introduce defined benefit pension plans, there are now only two players who are interested in the expansion of defined benefit plans. They are government and unions. Accordingly, public policy should be directed towards giving unions governance of defined benefit plans.

4.10 There are two basic flaws in this argument. Firstly, by-and-large employers *do* believe the defined benefit approach to be more desirable, but find that too many *disincentives* are being put in their way. *Over-regulation* has been overwhelmingly identified as one of the major barriers to expansion of coverage by pension plans, particularly defined benefit plans. In any event, to say that only unions and government are interested in defined benefit plans is a false premise. Secondly, this proposal would only relate to unionized employees, and would be of little if any help to non-unionized employees.

4.11 (5) Joint-Trusteed Plans. A more sensible approach, and one towards which legislation (particularly in Ontario and Québec) is moving us, is joint-trusteed plans. These already exist in the form of multi-employer plans, particularly in provinces like British Columbia, but there is no reason why the concept should not be extended to single employer plans, including non-union situations.

4.12 *If plans were to have joint trustees, representing* equally the members and the employer, the exceedingly irritating issue of surplus ownership could be resolved fairly quickly and effectively. More importantly, there would be room for a much less complex, and a much more liberal and pragmatic regulatory environment than we have today.

4.13 Among other things, we could move to a plan audit system (akin to that originally proposed, but dropped, by B.C.). Instead of filing all sorts of material such as plan documents, amendments, annual information returns, complete valuation reports, etc., and endlessly debating issues of detail with the regulators, we could move to a system where the joint trustees would be expected to run the plan in accordance with the laws and regulations. They would be required to file detailed annual information returns and little else, but they would be subject to audit by the regulators from time-to-time.

4.14 That's precisely how our tax system works, with all its complexities. This would be a much more constructive form of regulation than the present system which is doing nothing but damaging, even destroying, the private pension system, particularly the defined benefit system. This approach would remove many of the obstacles to coverage that clearly exist under the current regulatory environment, and is more likely to catch the wrong-doers, few as they may be. But even with this approach there will still exist many situations where there is no plan at all.

4.15 (6) Mandated Plans. So, why not mandate that every employer be required to have a defined benefit plan? Such a provision was included in the original Ontario Pension Benefits Act in the early 1960s, but was dropped with the passage of the C/QPP Acts, which was taking place at about the same time. The Ontario Royal Commission, in its 1981 report, recommended a system of mandatory money purchase plans, but with somewhat cumbersome reporting and administrative requirements. That proposal, as with many that tried to deal with the coverage issue, got lost during the 1980s, as issues other than coverage became all too dominant.

4.16 Perhaps some sort of mandatory system involving locked-in RRSPs and/or pension plans could be made to work. Indeed, the *IBIS Review* reports that Australia is about to join Finland, France, Sweden and Switzerland as nations *requiring* employers to provide pension coverage. According to reports received in Canada, Australia would require employers to contribute 3% of basic pay of employees to an approved pension scheme, effective July 1, 1992. If a company has an annual payroll of more than $500,000 Australian (about $435,000 Canadian), the contribution rate will be 5%. In subsequent years, the contribution rate is scheduled to increase to 9% by July 1, 2000. It is interesting to note that the 9% required employer contribution is exactly half the 18% combined employer and employee contributions now allowed for tax sheltered savings in Canada.

4.17 (7) Regulate RRSPs. Some would argue that, with RRSPs taking on a much more significant role in the future (as evidenced by our earlier figures), and recognizing that these provide tax incentives to save for *retirement*, why not restrict their use to retirement savings? In other words, lock them in completely.

4.18 This could easily be implemented through federal tax legislation and would avoid the problem of each province introducing different rules and regulations. Much of the future flow of funds into RRSPs will be transfers from pension plans and will be locked-in in any event.

4.19 (8) The "Contracting-Out" Compromise. As yet another potential solution, it has been suggested we consider a contracting-out system similar to the approach adopted by the U.K. some years ago. This is a compromise between expanding C/QPP and mandating private plans, since it would allow companies (and possibly individuals) to opt out of an expanded C/QPP provided they had a private plan that met certain minimum standards.

This compromise has a certain political attractiveness. It enables governments to say that we *are* expanding the C/QPP (labour's preferred option) and people can only opt out if they provide a similar level of private pension. It also enables governments to say to business and individuals that, while we are expanding the C/QPP, we are not forcing you into this. But such a system creates its own significant complexities and administrative difficulties. It may be great for actuaries and pension consultants, but is it the most effective solution; and how well understood would it really be?

4.20 (9) Better Understanding/Education. Lack of understanding has been identified as a major obstacle to pension coverage, along with the real and significant problem of regulatory overkill. There is no question that, with a better understanding by Canadians of the retirement system and of the need and means to plan and save for one's retirement, the problem of coverage will become less acute. Currently, people tend to feel that either governments will look after them, or that the company plan plus C/QPP and OAS will be enough, or that there is plenty of time in the future.

4.21 Even well educated and sophisticated people find it difficult to believe that, on average, one needs to put 18% of annual earnings away in tax sheltered vehicles for about a 30 year period if one is to have a decent pension at retirement. And yet that is precisely the rationale the Canadian government used to come up with the levels of contribution it considered reasonable for tax sheltering purposes.

4.22 The current Ontario government has also stated that education in the area of pensions is important and necessary. Accordingly, the government and the private sector need to find ways, alone and together, to ensure such education is forthcoming. And such education needs to commence at school age, not just with those approaching retirement age. Not only will this enable people to better understand both the need to plan for retirement income and the means to achieve their goals, it will also enable them to understand the issues. And this in turn will lead, hopefully, to a more informed decision making process in this area.

5. Conclusion

5.01 The most important thing is to find a sensible way of providing for Canadians' retirement income needs, without assuming their children and grandchildren will quietly and passively accept the potentially huge burden being sent their way. Perhaps, in the end, a combination of some or all of the potential solutions outlined above (or others) will prove to be the best approach. But Canadians cannot allow the issue of coverage to again be pushed to the back-burner as it was during the 1980s. We are rapidly running out of time.

Appendix

Compound Rate of Increase of CPI

		Percentage
5 Years	1941 - 1945	2.15%
	1946 - 1950	7.22
	1951 - 1955	1.86
	1956 - 1960	2.04
	1961 - 1965	1.78
	1966 - 1970	3.50
	1971 - 1975	8.21
	1976 - 1980	8.91
	1981 - 1985	6.77
	1986 - 1990	4.49
10 Years	1941 - 1950	4.65
	1951 - 1960	1.95
	1961 - 1970	2.64
	1971 - 1980	8.56
	1981 - 1990	5.62
25 Years	1941 - 1965	2.99
	1966 - 1990	6.36

Source: Canadian Institute of Actuaries: Report on Economic Statistics 1924 - 1990.