

Workplace Pensions: Trouble in Pillar 3



Presentation to “Older and Wiser” Conference

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Issues Addressed in the Presentation

- **Should we be worried about the declining portion of the workforce participating in RPPs (workplace pensions)?**
- **Should we consider DB and DC pension plans as a bimodal choice?**

Note: RPPs are most relevant for lower middle earners and up

Paradox of RPP Coverage

- **Portion of workforce participating in workplace pensions has declined steadily since the late 1970s** (46% in 1977 to 38% in 2008)

BUT

- **Total incomes of older Canadians keeps increasing as does 3rd pillar income** (RPPs and RRSPs)

Influences Offsetting Declining Coverage

- **Increased use of RRSPs: through mid 1990s**
- **Increased employment population ratio: stable proportion of adult population participates***
- **Less severe decline in coverage at family level***
- **Regulatory changes in late 1980s: changes relationship between point in time coverage and outcomes in retirement**

** Reflects increased female LFPR*

Looking Ahead

- **Offsets have limits**
- **Upward pressure on RPPs contributions/retirement savings**
 - *Increase in ratio of retirement period to employment period*
 - *Gap between wage growth and investment returns may narrow*
- **Incomplete substitution of non-pension wealth**

DB versus DC

- **Many points of contrast. For example:**
 - *DB (pure form) provides certainty of benefits and uncertain contributions*
 - *DC (pure form) does the opposite – certainty of contributions, uncertainty of benefits*
 - *DB regularly adjusts the rate of pre-retirement saving to hit an income target*
 - *DC adjusts benefits to reflect pre-retirement savings and investment returns*

Spectrum of Choice

- **DB: certainty of benefits (uncertain contributions)**
 - *Final earnings with price (wage) indexation*
 - *Final earnings with contingent indexation*
 - *C/QPP*
 - *DC with guaranteed rate of return*
 - *Notional DC*
 - *Nominal career earnings with contingent indexation*
 - *Flat benefit with ad hoc indexation*
 - *Target benefit multi-employer pension plan*
 - *DC with DB guarantee**
 - *Pure DC*
- **DC: certainty of contributions (uncertain benefits)**

Points to Consider

- **Some DB plans define very little**
 - *Risks: inflation, default, change in employers etc.*
- **OECP data on participation in DB plan types**
 - *Equal participation in SEPP, MEPP and JSPPs*
- **IN DB, sponsor(s) offer warranty against downside of A/L mismatch**
- **All DBs have an element of target benefits**

***Big lesson of 21st century: limits to the warranty
(not just in SEPPS)***

Problems at Both Ends of the Spectrum

□ DB end:

- *Gap between unconditional promise and ability to deliver*
- *Limited tolerance for contribution rate increases*

□ DC end:

- *Significant uncertainty about benefits and/or retirement age*

Solution: Accept spectrum and offer as much certainty of benefits as compatible with associated uncertainty of contributions