Pensions: A Basic Introduction

CEP 87M (SONG)
Representative Council
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What Are Our Goals for Retirement?

- All older Canadians should have enough money to live with dignity.

- Workers should be able to retire with a pension that will let them maintain their standard of living.

- Workers should be able to retire as early as possible but most importantly when they want.

- The surviving spouses of retirees should be able to maintain their standard of living.

- Pension income must be protected from inflation so that workers and their spouses can maintain their standard of living through their retirement.

WHAT DO PEOPLE LIVE ON WHEN THEY RETIRE?

Retirees in Canada have three main sources of income, or what is often called a “three tier” retirement income system.

- The first tier is provided by federal and provincial governments to ensure that all seniors have a minimum level of income.
- The second tier is the government-sponsored Canada Pension Plan or Quebec Pension Plan.
- The third tier is made up of private pension plans and savings.

OLD AGE SECURITY

- The first tier is the income security programs provided by the government. These programs are aimed at providing **all** Canadians with some income in retirement. The federal Old Age Security pension is the cornerstone of these programs.
- Old Age Security is paid to almost all Canadians who are 65 or older. Bankers, clerical workers, journalists or homemakers all receive this pension.
- Old Age Security is paid for by your federal taxes. You don’t have to contribute to it to receive the pension.
- It is indexed to inflation. Since July 1, 2010 the maximum monthly payment has been $518.51.
- For retirees who have little or no income other than Old Age Security, there are federal and provincial programs, which provide a top up. Unlike Old Age Security, the amount of money you receive from these programs depends on your income. These programs provide a minimum income to all Canadians. But, they aren’t high enough to keep you from being poor.

Canada and Quebec Pension Plans

- The second tier is the Canada and Quebec pension plans (CPP and QPP). The CPP and QPP are funded strictly through contributions by workers and employers. There is no government subsidy.

- All workers in Canada must participate in the CPP or QPP. For more than half the workers in Canada, it is the only work-related pension they will receive.

- CPP and QPP benefits are set at 25 per cent of earnings to a maximum of the average industrial wage. It is fully indexed to inflation.

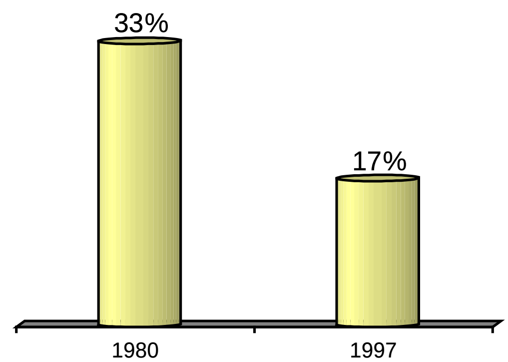
- In addition to a normal retirement benefit at age 65, the plans offer early retirement at age 60, disability pensions at any age, a lump sum death benefit, survivor benefits, and, benefits for dependants.

Private Pensions and Savings

The third tier includes private pension plans and registered retirement savings plans (RRSPs). These are two different ways that people save for their retirement. Pension plans are an agreement between workers and employers to put aside part of a wage package for retirement. RRSPs are an individual way of saving for retirement. Both kinds of retirement savings get the same tax breaks.

ARE WE MEETING OUR GOALS FOR RETIREMENT INCOME?

THE GOOD NEWS….



In 1980 20% of married couples were defined by Statistics Canada as being low income. In the same year 61% of single men and 72% of single women fell into that same category. By 1992 the corresponding numbers were 8% for couples and 36% and 55% for men and women respectively. The latest figures for 2003 showed 5.3% of couples, 31.7% of men and 41% of women fell below the low-income cut-off.

In other terms, the average total income for senior married couples in 1980 was $39,800, for men $22,400 and for women $17,800. In 1993 the corresponding numbers were $43,100 for couples, $26,500 for men and $21,200 for women. By 2003 the numbers were $49,300 for couples and $29,600 for men and $24,800 for women. (All the dollar amounts are expressed in 2003 constant dollars.)

BUT, WE NEED TO KEEP PUBLIC PROGRAMS…

- The CPP and OAS/CPP are important sources of income for seniors. They keep a lot of seniors out of poverty. These plans accounted for almost 43 per cent of the average senior's income in 1996. In 2001 32% of people 69 years of age or older were reliant on public pensions for at least three quarters of their total income.

- In 2002 only 20% of people 69 or older had private pensions. It is very dramatic that their income was more than double the other 80 per cent -- $43,000 versus $20,200.

- The baby boom is getting close to retirement age. People are living longer. Both the number of Canadians over age 65 and the share of the total population over 65 are increasing. This does mean that the costs of these programs will increase over the next 25 years. But, it doesn't mean that there is a 'crisis' in public pensions. What it means is that these programs will become more important.

- But, even seniors with the maximum CPP or QPP pension, along with the other public programs, don't receive enough money to keep them out of poverty. And, maintaining your previous standard of living is impossible on public pensions alone.

PRIVATE PENSIONS AREN'T MAKING UP THE DIFFERENCE....

- Less than a third of private sector workers have pension plans. And, if you work in a large paper you are more likely to have pension plan than if you work in a small independent community paper. Men are more likely to have a pension than are women.

- About 66 per cent of all pension plan members in the private sector work for firms with 1000 or more employees. This is because unions have been successful in organizing and bargaining for pensions in large industrial workplaces. However, in smaller workplaces, pension plans are rare.

- Men account for 66 per cent of private sector pension plans members. Women, who work in the private sector, are more likely to work in low wage jobs without benefits like pensions.

- The numbers improve when you include private plans in the public sector because there are significantly more women in these plans. Overall 51% of private plan members are men.

- In 2009 only 6 million Canadians were members of an employer sponsored pension plans.

EVEN IF YOU HAVE A PENSION PLAN, IT MIGHT NOT BE ENOUGH...

- Only 1 per cent of all private sector pension plan members have full CPI inflation protection. Only 14 per cent had partial CPI protection. 83 per cent had no inflation protection.

- Without any inflation protection, your pension can be eroded. Even in times like these when inflation is low.

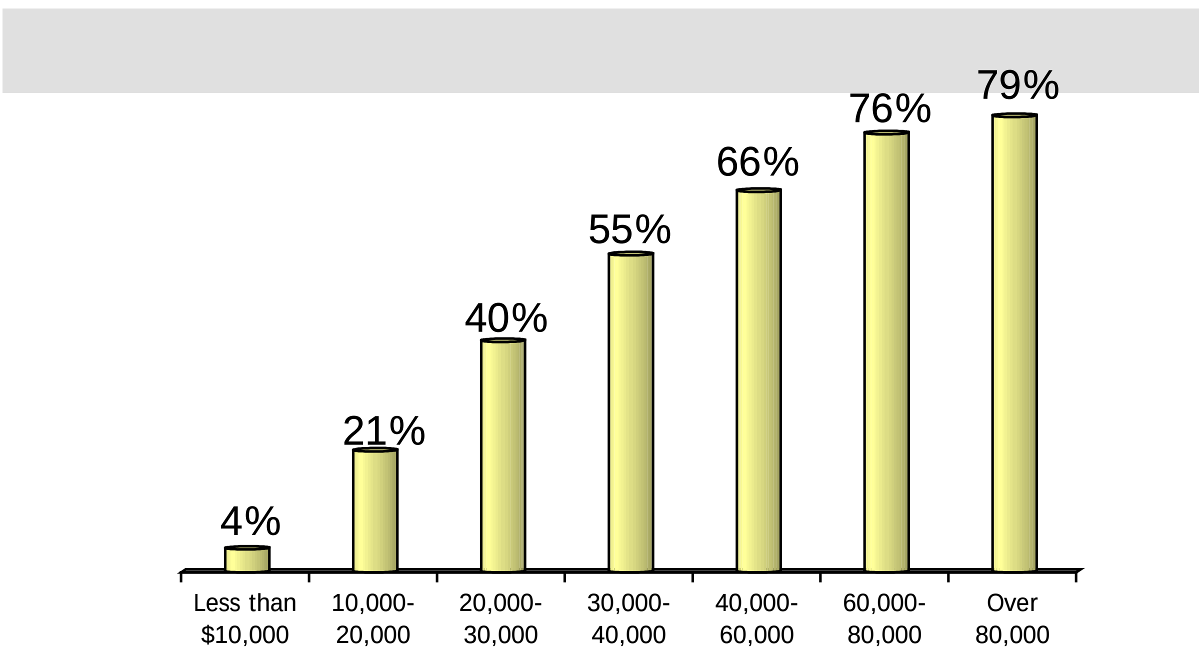
- Every private plan is under enormous employer pressure to change, shifting risk from the employer to the plan members.

BUT, WHAT ABOUT RRSPS?

- RRSPs are a way that government encourages people to save for their retirement on their own. But RRSPs must never be seen as a replacement for employer provided pension plans. From a public policy point of view, the RRSP system is not fair.

- Almost 66 per cent of tax filers with incomes between $40,000 and $60,000 or more used RRSPs and made an average contribution of $4,258. Only 21 per cent of tax filers with incomes between $10,000 and $20,000 contributed to RRSPs. Their average contribution was $1,892.

  The average savings per year in 2004 reveal something obvious, the more you earn, the more you can save. The average savings for income earners between $30 - $39,000 per year was $3,523. For those earning $80,000 or more the average savings were $13,640 per year.



How Do We Meet Our Goals for Retirement Incomes?

As Unionized workers, how can we meet our goals for pensions for ourselves and for other workers?

We have to continue to negotiate for better pensions, for more of our members.

The Labour movement has had a lot of success in negotiating better pensions and in improving pension legislation in Canada. In Ontario, the Labour Movement fought off an employer-inspired government proposal which would have allowed employer raids on plan surpluses.

But, the combination of stronger pension legislation, improved pensions, and an ageing population has made employers fight harder against the cost of pensions. Employers are trying to pressure bargaining committees and sometimes workers directly, to give up what they have gained over years of bargaining for pension plans.

The pressure will continue to increase to roll back pension benefits in both the public and the private sphere. But, as our membership grows older, pension will become more of a priority in bargaining. Recently there have been a number of compromises in bargaining that have reduced pension options for employees.

Because both public and pensions are regulated by a legislative framework, we can not lose sight of the political action that will be necessary to maintain the public pension system and defend the private system against future raids by employers.

If the public system provided enough income, all workers would be able to live their retirement years with dignity. As it is, only those workers who can negotiate substantial private pensions can maintain a decent standard of living.

We have to fight to maintain and even improve the CPP.

WHAT DOES "MAINTAIN STANDARD OF LIVING MEAN"?

One of the goals for retirement income is to maintain our standard of living. A general rule-of-thumb is that retired workers need 75% of their pre-retirement income to maintain their standard of living.

In general, post-retirement income doesn't need to be as high as pre-retirement income. Some expenses are lower for retirees and, pensioners may be eligible for senior citizen discounts. While individual retirees will spend differently and have different needs, there are some general changes in expenses and spending that occur for all retirees.

- Retirees don't have some of the payroll deductions that they had when they were working: they don't have to contribute to CPP/QPP or UI and they have no more pension contributions (if member of contributory plan)

- Currently, there is no tax on first $1,000 of pension income and a tax credit at age 65.

- After retirement, there are many expense items that **may** be reduced or disappear including mortgage payments; life insurance premiums; clothing for work; transportation to work, and, the expense of raising kids.

There are other benefits that may be available only to people over age 65, such as drug plans in some provinces, and, low-cost public transit in most cities. These benefits vary from community to community. It is important to note that many of these factors that reduce seniors' costs take effect **only** at age 65. They do **not** benefit early retirees.

There are many retirement income calculators on the internet that can help you determine how much you will need when retired. Service Canada's is, obviously not linked to any products.

http://www.servicecanada.gc.ca/eng/isp/common/cricinfo.shtml

HOW IMPORTANT ARE THE OAS / CPP TO YOUR RETIREMENT INCOME?

We need a pension that is about 75 per cent of our pre-retirement income to live comfortably in our old age. Both OAS and CPP make up an important part of that income. Combined these two programs make up about 43 per cent of average retirement earnings. That means that pension plans only need to make up the remaining 32 per cent.

For the average Canadian senior (in 1996):

- 25 per cent of their income came from OAS and GIS
- 18 per cent of their income came from CPP
- 17 per cent of their income came from private pensions

So, 43 per cent of the average senior's income came from OAS and CPP, compared to 17 per cent from private pensions

Because of the changes in the economy, the CPP will be a more important source of income in the future.

With the increasing levels of worker mobility either forced through a permanent lay-offs or voluntary as people change jobs, workers can no longer count on contributing to one private pension plan for their whole working life.

Workers are moving from job to job, some of which have pension plans, some of which don't. More workers are finding themselves forced into low wage jobs in the service sector without any private pension benefits. More workers are in "contract" jobs or "freelance" positions with no benefits.

In all these situations, the CPP is, probably, the only pension plan workers will get. So, we expect the CPP to become a more important source of income for the next generation of retirees.

Protecting these pension plans is as important to our retirement incomes as bargaining with employers for better pensions.

WHAT IS THE OAS?

Old Age Security (OAS) is a non-contributory benefit that is paid for out of tax revenues.

The OAS provides a benefit to all Canadians who meet certain residency requirements. You are entitled to a **full** pension if:

- You must be 65 years of age or older.
- You must live in Canada and be a Canadian citizen or legal resident at the time of application.
- You must have lived in Canada for at least 10 years after turning 18.

With the minimum of 10 years residence, you are eligible for a partial pension equal to 1/40 of the full benefits for each year of residence between the ages of 18 and 65,

The benefit starts at age 65 and it is fully indexed to inflation. As of July, 2010, the maximum benefit is $518.51 per month.

Seniors with individual incomes higher than about $66,733 have their OAS ‘clawed back.’ While they receive OAS payments, they have to pay back some or all of it through the tax system. The full OAS is eliminated when a pensioner’s net income is $108,152 or more.

There are a number of other programs, associated with the OAS, which provide income to poor seniors. The federal program is the **Guaranteed Income Supplement (GIS**). The GIS is a payment to seniors who have little or no income other than Old Age Security.

The maximum GIS benefit in July 2010 is about $655 per month. For a couple it is about $1086 per month. It is reduced by $1 for each $2 of income other than the OAS. The GIS benefit is reduced by payments from C/QPP, private pension plans, and employment income.

A spouse's allowance is payable under the Old Age Security Act to all "low income" spouses, widows and widowers of OAS pensioners between the ages of 60 and 65. Maximum spousal allowance since July 2010 is $950.70 per month.

Several provincial governments also have plans that guarantee minimum incomes to elderly people by providing residents over age 65 with supplements to top up the federal benefits. Alberta, British Columbia, Manitoba, Nova Scotia, Ontario and Saskatchewan all have supplementary programs that pay various benefits.

Because so many retired workers are not covered by private plans, many people are eligible for some GIS when they retire. Others, who are members of private plans with low benefits and without inflation protection, start receiving GIS benefits when they are older, after inflation has eaten away the value of their private pension. About 40 per cent of seniors receive GIS benefits.

How do the Canada Pension Plan / Quebec Pension Plan Work?

The Canada and Quebec Pension Plans (C/QPP) are the most important part of the employment related pension system in Canada. They are government administered pension plans that are funded out of contributions by employers and workers. There is no government subsidy.

Almost all workers participate in the C/QPP through compulsory employer and employee contributions based on earnings.

The C/QPP provide pension benefits of 25 per cent of pre-retirement earnings to a maximum of the average industrial wage. Full benefits are paid at age 65. Early retirement benefits are available at age 60. The pension is reduced by 6 per cent for each year that you retire earlier than 65.

Everyone's C/QPP benefits are protected from inflation that happens before their retirement and inflation that happens after their retirement.

In addition to retirement benefits, the C/QPP provides for survivor benefits and disability pensions.

The C/QPP provides benefits after the death of the pension plan participant. These benefits include: a pension for a surviving spouse; orphan's benefits, and, a death benefit.

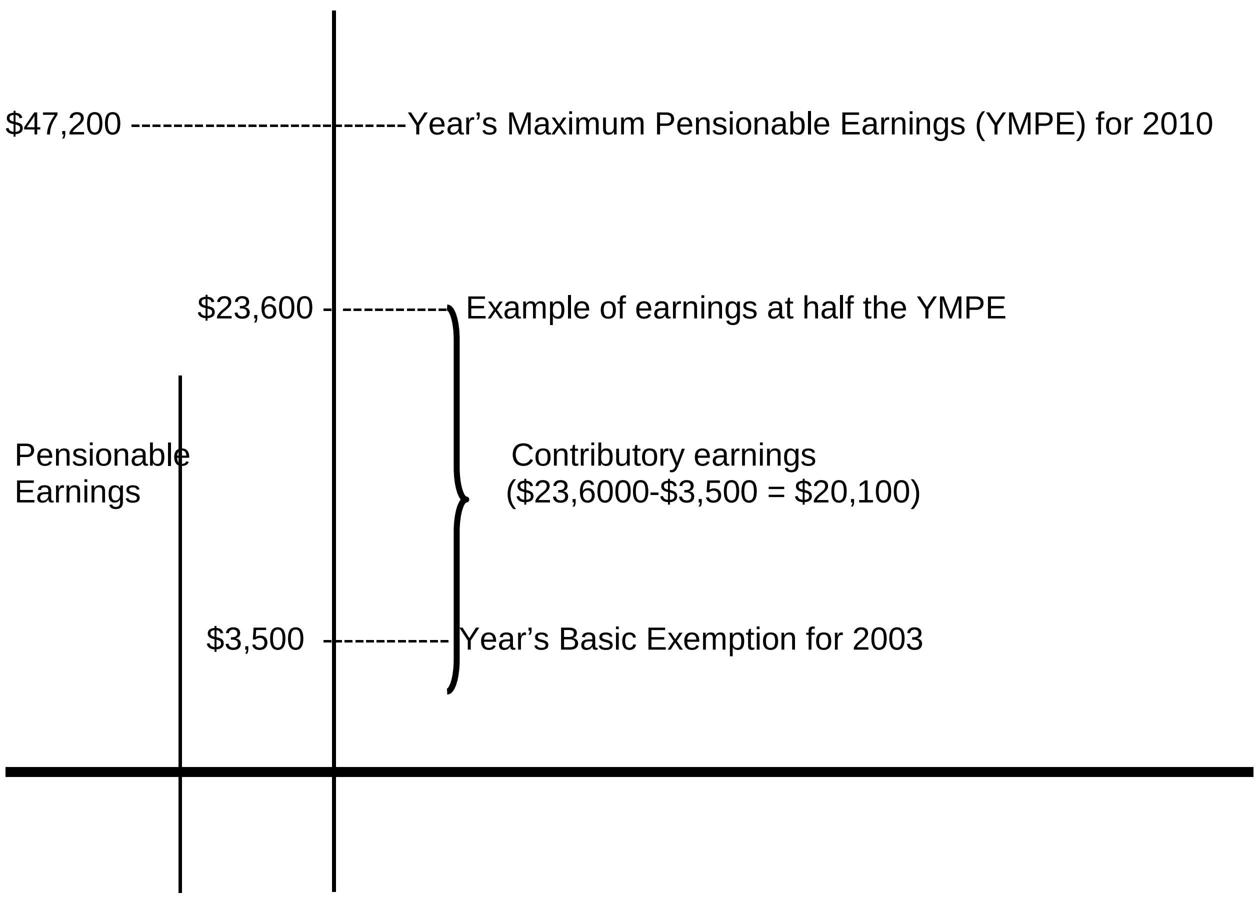
The C/QPP provides a monthly pension to disabled workers who are participants in the plan, and, a monthly pension to the dependent children of the disabled worker. Eligibility requirements for this benefit are strict. The disability must be severe and prolonged. *Severe* means that you are not able to regularly pursue any substantially gainful employment. *Prolonged* means that the disability is likely to be permanent.

HOW DOES THE C/QPP WORK?

CONTRIBUTIONS

Employers and employees contribute equally to the plan. In 2003, total contributions are 9.9 per cent of contributory earnings. Employees pay 4.95 per cent and employers pay 4.95 per cent. (The maximum contribution is capped at $2,163.15 per year.)

CPP/QPP CONTRIBUTIONS



BENEFITS

Your benefit is 25 per cent of your adjusted average earnings.

Adjusted average earnings are calculated using 25% of 1/12 of the average YMPE for the last five years.

The 15 per cent of years in which you had the lowest earnings will be automatically dropped. In addition you can choose to drop out any years in which you were the primary care giver of a child under 7.

You will receive the maximum benefit if you earned the Year's Maximum Pensionable Earnings (YMPE) each year that you were between 18 and 65 years of age (after 1966). You will still be able to receive the maximum benefit if you earned the YMPE for all but 15 per cent of those years.

Years in which you are laid off, off work on disability, or, have taken early retirement and are not collecting CPP are years at zero income. Therefore, they can reduce the pension you are eligible for at retirement.

It is important to remember that **you must apply to collect the C/QPP**. No payments are made retroactively. You should apply six months before you wish to begin collecting, and you may apply as much as one year before.

CPP/QPP BENEFITS

Maximum Monthly Benefits from the Canada Pension Plan, 2010

	CPP	
Retirement at 65	$934.17	
Disability	$1,126.76	

Maximum Monthly Benefits from the Canada Pension Plan, 2010		
Survivors 65 and older	$560.50	
Survivors under 65	$516.57	
Death Benefit – maximum i time payment	$2,500	
Children and Orphans	$214.85	

Why the CPP is a Good Pension

- The CPP provides a pension to everyone, no matter what sector of the economy in which they work.
- It provides a pension for full-time, part-time, and self employed workers.
- The CPP is completely protected from inflation.
- Unlike many private pension plans, it doesn't matter how many times you change jobs, you'll still get a benefit based on all your earnings from all your jobs when you retire.
- The CPP allows you to retire anywhere from age 60 to age 70.
- It allows spouses to share their benefits at divorce or retirement and it has benefits for the surviving spouses of contributors.
- It doesn't penalize women or men who are out of the labour force raising children.
- It provides disability benefits even if the cause of the disability is not work-related.

WHAT IS A PENSION PLAN?

A registered pension plan is a formal, organized method of saving for the future. While all pension plans are ways of saving for the future, they can have very different ways of distributing those savings.

When you think about the money in a pension plan, there are three categories:

- **contributions**, are the money coming into the fund;
- **the pension fund**, is the money that has accumulated in the pension plan;
- **benefits**, are the payments made to pension plan members.

There are three factors that determine the size and growth of pension funds:
- time;
- contributions;
- interest payments, earnings and changes in the value of investments.

Time is a key feature. Contributions must be made **today**; benefits are paid out some time in the **future**. At any one time we cannot know for sure what both the contributions and the benefits will be.

This is because contributions are not the only source of funds. The **interest** earned on contributions increases the amount of money available for future pensions.

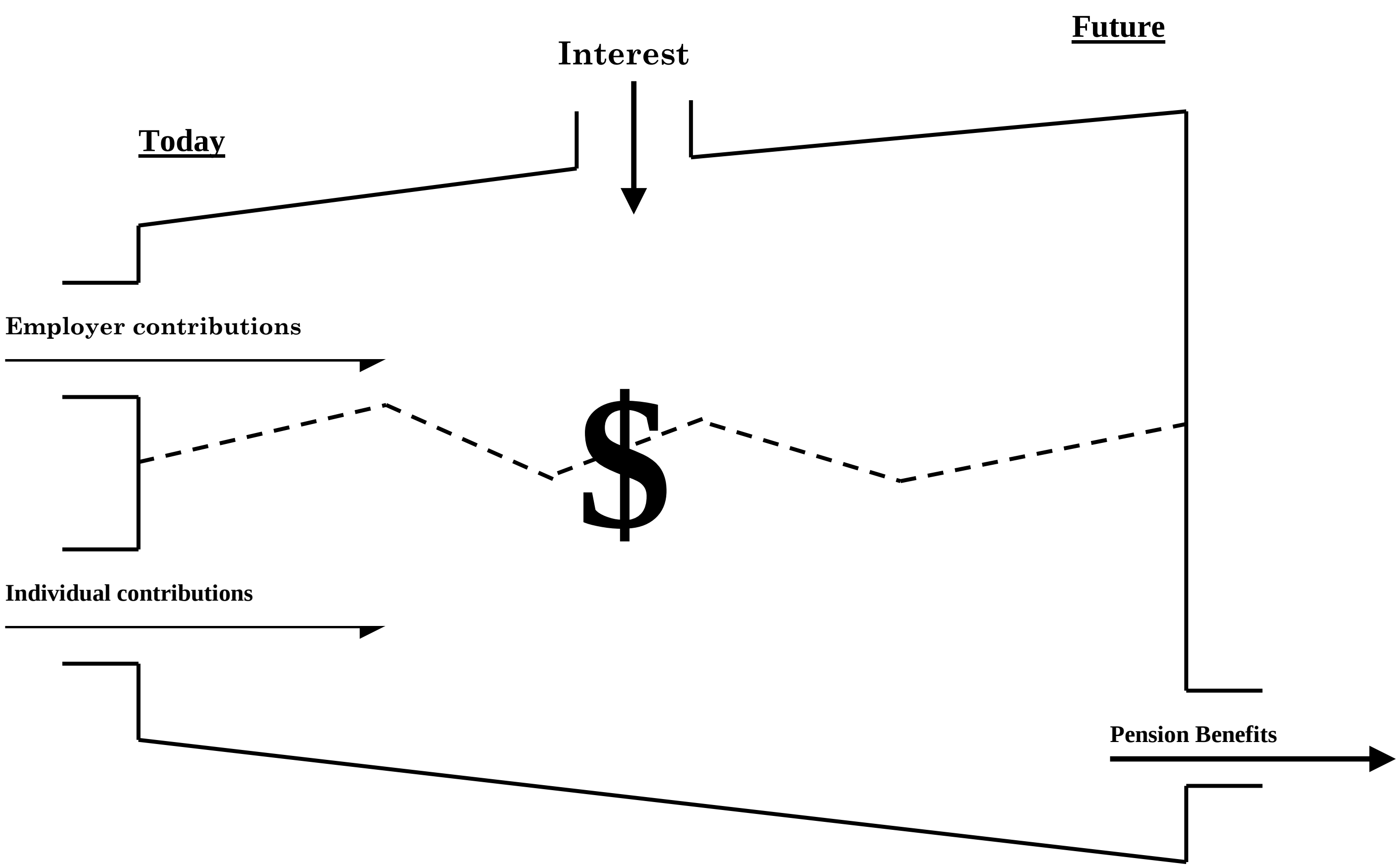
We don’t know what interest rates will be in the future. And that means we don’t know for sure what the money that is in the pension fund now will be worth in the future. There are two ways you can think about that uncertainty.

Without knowing the value of the fund in the future we can't know what level of benefits can be provided from the fund. Or, we don’t know how much we have to contribute now to fund a given level of benefits in the future.

When a pension plan is established the plan sponsors must decided how to deal with this uncertainty. The plan can establish a known, pre-determined level of contributions, or a known, pre-determined level of benefits.

Depending on the choice, two very different pension plans result.

DIAGRAM # 1


Future
Interest
Today
Employer contributions
$
Individual contributions
Pension Benefits

MAJOR KINDS OF PENSION PLANS

DEFINED BENEFIT OR DEFINED CONTRIBUTION

There are two major kinds of pension plans: defined benefit plans and defined contribution plans.

- In a Defined Benefit Plan (DB) the union negotiates the ***benefits*** that will be paid out of the pension plan. The starting point of a DB plan is the retirement needs of the employees and their spouses.

- In a Defined Contribution Pension (DC) plan the union negotiates the ***contributions*** the employer makes to the pension plan. The starting point of a DC plan is the "affordability" of the contributions.

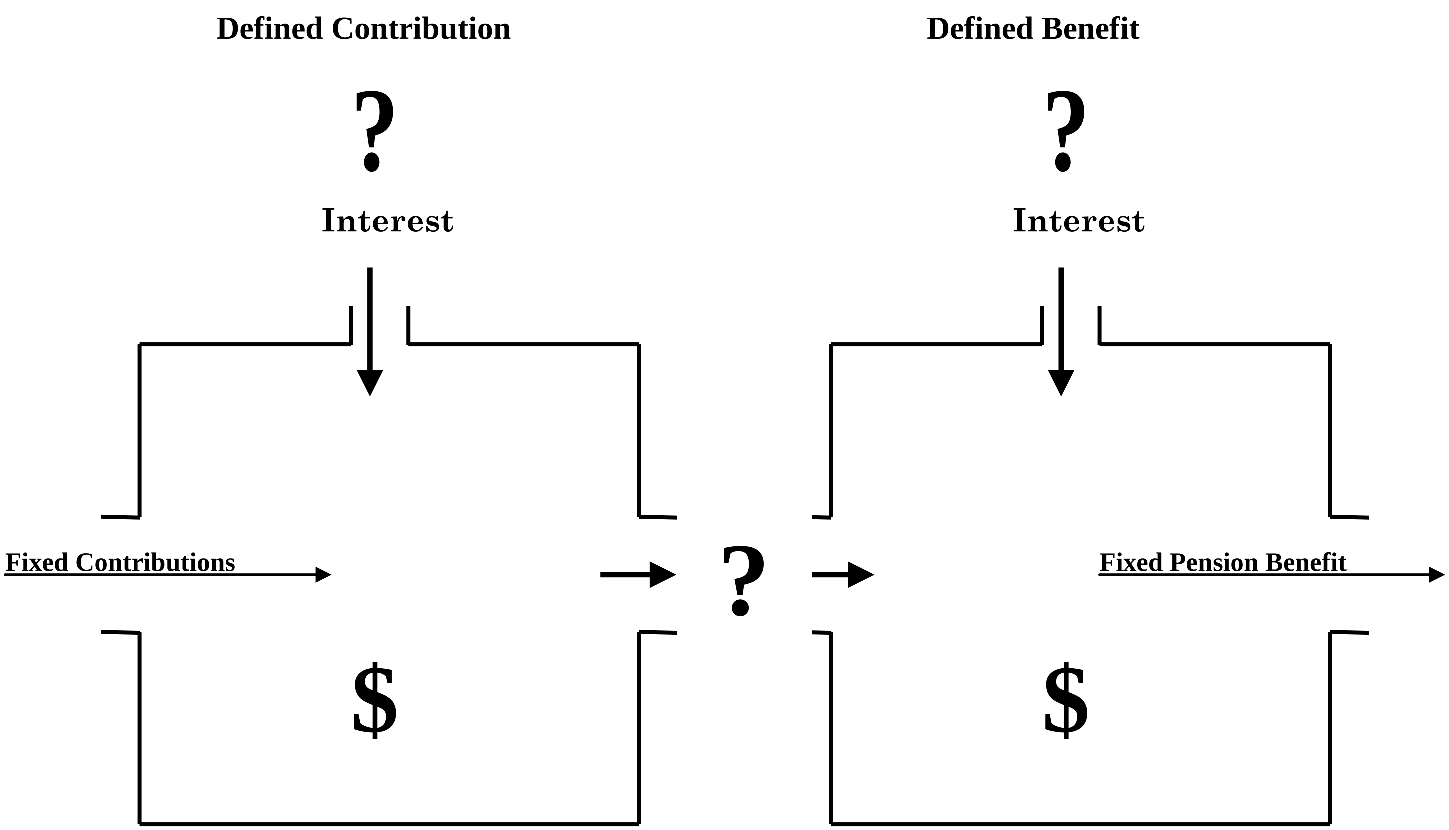
In a Defined Contribution pension everyone knows exactly how much money will be put into the pension today, but no one knows the amount of pension income that will come out of the plan at retirement. The DC plan is really a series of individual savings accounts, like RRSPs. There is no promise or guarantee on how big or small the pension will be. The ultimate pension that can be provided will be whatever can be purchased with the money in the individual's account at retirement.

In a Defined Benefit plan everyone knows exactly how much pensions will be, but no one knows for sure how much the pension will cost. Under a DB plan the employer makes a promise to pay a pension at retirement. The employer must then hire a pension actuary to estimate the costs, and contribute that amount to the pension fund. If the actuary's recommendation turns out to be wrong and there is not enough money in the pension fund to pay the promised pension, the company must contribute more.

In a Defined Benefit plan the union negotiates what ***comes out*** of the plan.

In a Defined Contribution plan the union negotiates what ***goes into*** the plan.

DIAGRAM #2



Defined Contribution
?
Interest
Fixed Contributions
$
?
Defined Benefit
?
Interest
Fixed Pension Benefit
$

OTHER DIFFERENCES IN PENSION PLAN DESIGN

The most important difference between pension plans is whether the plan is a defined benefit plan or a defined contribution plan. However, within those two groups there are a number of different ways that pension plans can work.

The first question is whether the employer makes all the contributions or whether both workers and employers make contributions.

The next question for defined contribution plans is what are the rules about how much is contributed to the plan?

The next question for defined benefit plans is how is the amount of your benefit determined?

WHO PAYS?

This is a question for both defined contribution and defined benefit plans. Both plans can provide for both employer and employee contributions. In both types of plans, the employer can pay the entire cost. Federal and provincial pension laws require a registered pension plan to provide for some employer contributions.

Often, bargaining committees prefer pension plans in which the employer pays the entire cost - a "non-contributory plan". However, in the end the difference between a non-contributory and a contributory plan may not amount to much. As anyone who has ever sat at the bargaining table knows, pensions are part of the total compensation package, and are 'paid for' by members in the same way as wages. The members pay even for a non-contributory pension plan. It might not be in direct contributions, but will be in the wage increases which have been given up in exchange for the employer’s pension contributions.

TYPES OF DEFINED CONTRIBUTION PLANS

In a defined contribution plan contributions can based on a cents per hour formula, a formula that pays a set percentage of annual wages, or a formula that pays a set percentage of profit. The last method is legally considered a Deferred Profit Sharing Plan a (DPSP) rather than a Registered Pension Plan (RSP) and is subject to different rules.

TYPES OF DEFINED BENEFIT PLANS

A defined benefit plan contains detailed rules setting out when pension benefits are paid, how much benefits are, and who receives the benefits. In all defined benefit plans there is one basic formula which sets out the pension paid at the normal retirement age. Additional plan rules set out how the amount produced by the basic formula is affected by such things as early retirement, termination, and survivor pensions.

Benefits can be directly related to earnings. There are three standard earnings related plans:

1. **Career Average Earnings Plan**

   The monthly benefit is a percentage of earnings in each year of employment. A typical formula would be 2% of average annual earnings times years of service. Another common formula in the newspaper industry is 2% of a negotiated base year earnings times years of service.

2. **Final Average Earnings Plan**

   The monthly benefit is a percentage of the plan members' employment income in the last 3 or 5 years. A typical formula would be 1.5% of the last 5 years' average earnings times years of service.

   This type of plan is considered to be a very good plan (even though it is not the maximum allowable), and is common for government employees, insurance industry, and salaried employees.

3. **Best Average Earnings Plan**

   This plan is similar to the final average earnings plan, except that the best 3 or 5 years earnings are used instead of the last 3 or 5 years. A typical formula would be 1.5 % of the best 5 years' earnings times years of service.

In addition to these earnings related plans there is the:

4. **Flat Benefit Plan**

   The retirement benefit is a flat dollar amount multiplied by years of service. For example a plan might provide a monthly benefit of $20 per month per year of service.

HYBRID PENSION PLANS

There are some pension plans that contain a mixture of elements of both defined contribution and defined benefit plans. The most common type of hybrid plan is a **target benefit plan**. This type of plan is **funded like a defined contribution plan** - the company and the union negotiate a fixed contribution to the plan. But, the pension **benefits are paid out like a defined benefit plan**.

The difference between a target benefit plan and a defined contribution plan is that the contribution is **not credited to individual accounts**. Instead the total contribution is treated as if it were a contribution to a defined benefit plan. An actuary then calculates what level of pension benefit can likely be supported by that contribution. That benefit will become the basis for the payment of each members' pensions over the next two or three years.

However, unlike a defined benefit plan, there is **no guarantee on this pension benefit**. If it turns out that the actuary's estimation was incorrect, either the benefit or the contribution rate will have to be adjusted.

From the company's point of view a target benefit plan is similar to the defined contribution plan because costs are fixed today, rather than estimated based on the promise of a future pension pay out. From the members' point of view the target benefit plan is similar to a defined benefit plan because the plan is based on a collective, rather than individual pay out. And this allows the plan to subsidize the pensions of older workers, and early retirees.

MULTI-EMPLOYER PENSION PLANS

Most work related pension plans are sponsored either by the employer alone or jointly by the employer and the union. Each company will have a separate pension plan and a separate pension fund.

As the name suggests, multi-employer plans are plans where more than one employer is contributing to the pension fund, and where the pension benefit is determined by service at more than one employer. This type of pension plan is common in industries where there are a large number of small employers and employees move frequently between jobs. The multi-employer plan allows members to move between employers without losing part or all of his or her pension.

CEP has a multi-employer plan.

MAJOR DIFFERENCES BETWEEN DEFINED CONTRIBUTION AND DEFINED BENEFIT PLANS

A. HOW THE FUND CAN BE USED

One of the big differences between a defined benefit and a defined contribution pension plan is how the money in the fund can be used. A defined benefit plan can be designed to provide special benefits such as early retirement, survivor pensions and disability pensions. A defined contribution plan cannot provide any of these special features.

1. *Provision for past service*

In a defined benefit pension plan, past service can be credited when the plan is established or in later rounds of bargaining. When benefits are improved, they are often improved for both current and past service.

In a defined contribution plan, only the contribution rate and the duration of contributions matter. You can't credit past service. You can't improve past service benefits.

2. *Unreduced early retirement and bridge benefits*

Early retirement and bridge benefits are among the most popular additional benefits negotiated into pension plans. Because the pension fund is pooled, it is possible to negotiate these benefits.

In defined contribution plans, unreduced early retirement is not possible. Employees can retire early, but they pay an extreme penalty in lost pension income. The penalty comes in two ways. They have lower service and therefore have contributed less. And, their money has had less time to earn interest.

3. *Higher Pensions for Older Workers*

In a defined benefit plan, everybody in the plan earns benefits on the same basis, regardless of their age. Because it costs more today to provide a given benefit at retirement for an older worker than for a younger worker, the older members of a pension plan are always being subsidized by the younger workers.

In a defined contribution plan, each dollar contribution by a younger worker buys a much higher benefit at retirement than the same contribution by an older worker.

4. Disability pensions

Special disability benefits cannot be provided in a defined contribution pension plan. A disabled employee is left with only what has accumulated in his or her personal account -- for all but the oldest disabled plan members, a small fraction of what would be available at normal retirement.

5. Special benefits for surviving spouses

Many of the better pension plans provide special benefits for survivors of plan members who die either before or after retirement.

In defined contribution plans, the only pre-retirement death benefit is the amount of money that had accumulated in the fund at the time of death. A defined contribution plan cannot make special provisions for survivor pensions. Post retirement survivors can be provided for, depending on the kind of annuity that is chosen by the retiree, but the member's pension must be reduced to pay for the additional cost.

6. Inflation protection

Inflation protection cannot be built into a defined contribution pension plan. Plan members have to "buy" inflation protection at the time of their retirement by taking a lower pension at retirement.

B. Risk

In a defined benefit plan the employer takes the investment risk. In a Defined Contribution plan each individual employee takes the investment risk. The risks include:

- investment returns before retirement;
- inflation prior to retirement;
- market levels and interest rates at the point of retirement;
- inflation after retirement; and
- mortality rates after retirement.

This might all sound like a bunch of words. But, it can have a big impact on how much money you will have to live on every month.

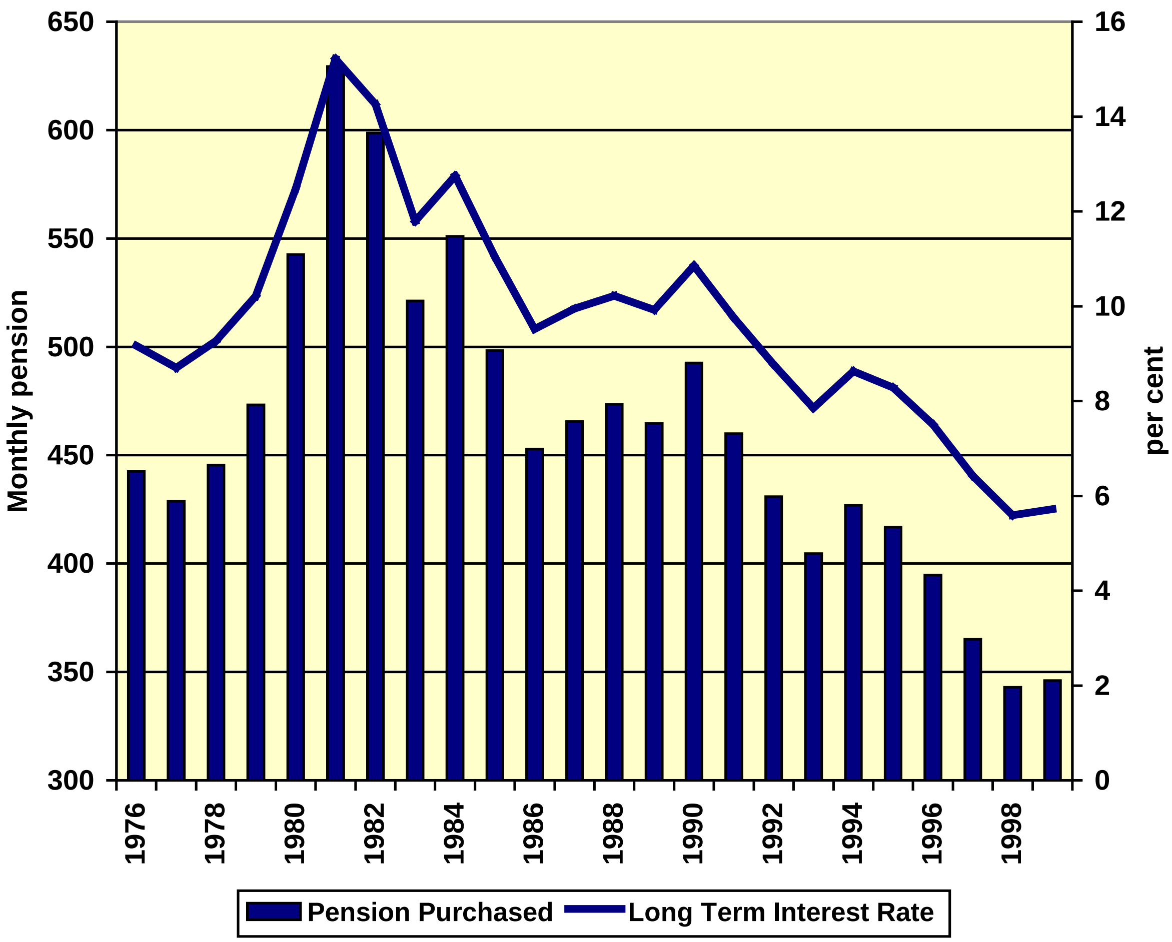
How Much Annuities Pay
(or what can I get for $50,000?)

Under a Defined Contribution Pension, the lump-sum amount of money in a member's individual savings account has to be turned into a monthly pension at retirement.

One way of doing this is to purchase an annuity from a life insurance company. An annuity is a kind of contract in which the insurance company agrees to pay a set monthly pension to the individual.

The chart below tells you the estimated amount of monthly pension income you could purchase with $50,000.

What can you get for $50,000?



In August 2010 this amount had dropped to $265 per month.

The same $50,000 purchases different pension amounts in different years.

Why? Annuity prices depend on interest rates. (Along with a number of other factors such as age and sex.)

In general, the higher the interest rate, the greater the monthly pension that can be purchased for a set amount of money.

Conversely, the lower the interest rate, the lower the monthly pension that can be purchased.

That means under a defined contribution plan, your final pension will depend on interest rates not only prior to retirement, but at the time you purchase an annuity.

The Advantages of Defined Benefit Pensions
(or What's Wrong with Defined Contribution Plans?)

Here's what some actuaries are saying about the *advantages* of a Defined Contribution pension plan:

- the employer's cost is fixed;
- the employer can save money by introducing employee contributions;
- administration is simplified, and there is no need for an actuary;
- there are no disputes about surplus ownership (because there is no surplus);
- there is no potential cost from contributions holidays being banned;
- there is no concern about future increases in cost from potential new government legislation like pension indexing;
- the plan fits better with our new entrepreneurial corporate culture.

The question we must ask is : *"Whose advantage?"* It is clear that all of these so-called advantages benefit the employer, rather than workers.

Why do employers want to get rid of Defined Benefit plans?

It's all about money. Employers demand defined contribution plans because they believe that in the long run a DC plan will be cheaper than a Defined Benefit plan.

A Defined Benefit plan is essentially a promise to pay a pension in the future. Employers are no longer willing to make long term commitments to workers. Employers want workers with 'no strings attached'. The moment a worker stops working employers do not want to have any more responsibility for them, especially with respect to pensions.

Canada's workforce is getting older. As a result, workers are becoming more concerned about their pensions. Since employers have not been willing to provide good pension benefits over the last 10 - 20 years, they see significant pressures from workers and unions to improve pensions in the future. Under a Defined Benefit plan those cost increases will be the employers' responsibility. That means that not only will the employer be responsible for cost increases due to an ageing population, employers will also have to start paying for their past mistakes.

Employers are unhappy with Defined Benefit pensions because it requires them to guarantee payment of your pension into the future. It’s a guarantee that might cost them additional money in the future.

What arguments are used to convince employees that a Defined Contribution (DC) Plan is better for them?

Employers who want to convert to Defined Contribution plans make all kinds of outrageous and misleading statements about the advantages of DC plans.

A ‘good’ employer argument takes a bargaining committee or employees through a number of steps:

1. ***Existing pensions are not high enough.***
   True. But why? Because the employer has refused to increase pension benefits in the past.

2. ***Increases to existing DB pensions are not possible, because the unfunded liability created by increases for past service is not affordable.***
   Actually, it is not that costs are not “affordable”. Employers simply do not want to take on long-term financial obligations.

3. ***A DC plan will provide a higher pension, especially to younger employees.***
   False. If you look closely at the employers’ numbers you will probably find that the comparison between the DC pension and DB pension is rigged. The employer will make the DC pension look better by:
   (a) using a higher assumed investment return for the DC pension;
   (b) pretending that the DB benefit will not be increased in future rounds of bargaining, while the contributions into the DC plan continue forever;
   (c) ignoring the impact of inflation on the real value of DC accounts; and
   (d) putting more money into the DC plan by including *employee* contributions.

   An example of the last employer tactic would be to replace a DB plan that costs the employer, for example, an average of 6% of pay, with a DC plan based on employer contributions of 5% of pay <u>and</u> employee contributions of 5% of pay. Of course the DC plan looks better, there is almost twice as much money going into that plan. And to make it even better the employers’ cost has actually gone down!

4. ***A DB pension plan is "not fair" to younger employees, especially those who might not stay with the employer until retirement****.*
It is true that DB benefit pension plans favour workers who stay with the employer until retirement. Most DB plans currently do not pay good termination benefits to younger workers who quit or are terminated prior to retirement. But the solution is not a DC pension. Employers that are truly concerned about younger workers can simply improve existing DB pensions and make them portable. That means pension benefits can be transferred from one plan to another.

Divide and Conquer

In order to win over members to a DC pension plan the main thing the employer must do is frame the debate in terms of *individual* workers. Essentially the employer's strategy is 'divide and conquer'. Once the employer has members thinking in terms of themselves and what they get under a DC pension and their own RRSP room, the employer has taken 'the heat off'. Members are no longer focused on the employer's refusal to negotiate a good pension for everyone. The employer then exploits the weakness of the DB pension: poor termination benefits for younger workers.

Once members are thinking in individual terms they like the sound of DC plans that suggest that they can have "greater control" over their own pension investments. What is overlooked is that the level of real "control" individual members have over investments is very limited, and that workers' collective influence over pension investment is diminished.

What about proposals to combine a new DC plan with an existing DB plan?

The most clever employers have discovered that it is difficult to convince people to simply drop existing DB pensions. In order to try deal with arguments against the DC plan, these employers propose:

(a) a long-term phase out of the DB pension;
(b) higher contribution levels for older workers; and/or
(c) a transition period that guarantees pensions for people about to retire. Some employers are even prepared to pay a little more in the short term to the pension plan, to get out of the long-term obligations of the DB pension.

These proposals look more attractive, and are better, but they do not address the fundamental problems with the DC pension: the employer is not responsible for guaranteed pensions and the individual accepts the investment risk.

What about a DB plan for existing employees and a DC plan for new hires?

Again employers are thinking of long-term costs. A two-tiered pension system will seriously divide the membership. It will pit younger workers against older workers and weaken the union's bargaining strength.

WHAT IS WRONG WITH A DEFINED CONTRIBUTION PLAN

- Takes away the guaranteed pension. Employers' do not want the responsibility or risk of funding pensions. Employers want each individual to take the risk of funding his or her own pension.

- Makes it impossible to know what your pension will be at retirement. Your pension is completely dependent on the interest earned in your account.

- Gives everyone a different pension. Each pension will be different based on investment returns and length of time to retirement. And that will make it very hard for the Union to negotiate pensions in the future (imagine how hard it would be to negotiate wages if everyone in the plant was making a different wage!)

- Cannot include unreduced early retirement benefits like 30 and out.

- Cannot include minimum disability pensions.

- Cannot include favourable survivor pensions.

- Cannot include bridge or supplementary pensions paid at early retirement.

- Cannot include inflation protection.

- Cannot negotiate improvements in past service.

- Makes it impossible to provide good pensions for older workers close to retirement.

For more Information you can look at a variety of sites on the internet:

The Service Canada CPP Information web site:

http://www.servicecanada.gc.ca/eng/isp/pub/factsheets/retire.shtml#b

The CLC CPP reform Plan web site:

http://www.canadianlabour.ca/action-center/retirement-security-for-everyone

Vancouver Sun article of Pension reform:

http://www.vancouversun.com/business/Pension+contributions+Reaction+pours+reform+proposals/3181470/story.html

Canadian Centre for Policy Alternatives Proposal for Pension Reform:

http://www.policyalternatives.ca/publications/reports/options-pension-reform

Canada's retirement-income provision:
An international perspective -- An OECD Paper:

http://www.fin.gc.ca/activty/pubs/pension/ref-bib/whitehouse-eng.asp

Ministry of Finance Consultation Document, May 2010

http://www.fin.gc.ca/activty/consult/retirement-eng.asp

Retirement Security for Everyone
Get the Job Done.

Retirement security reform - Double CPP

We propose a doubling of the Canada Pension Plan (CPP) benefits to ensure a better minimum pension for all Canadians. This would be financed through a modest and gradual increase in contributions over seven years, following the pattern set by CPP reforms in the 1990s.

Our plan is endorsed by Bernard Dussault, who was the Chief Actuary of the CPP and Old Age Security program from 1992 to 1997.

Currently workers and employers pay 4.95% of salary into the CPP (up to a current “Yearly Maximum Pensionable Earnings” limit of $46,300 per year). Following our seven-year plan, CPP contributions would gradually increase to 7.8% of salary for workers and employers.

These increased contributions would effectively double the average earnings replaced by CPP pension benefits, to a maximum (in 2009 dollars) of $1,635 per month.

Some might be surprised that an extra 3% of salary can finance a doubling of CPP pension benefits. This is because the CPP structure is so cost-efficient, it is possible to achieve more with less. CPP reform offers much more than “fend for yourself” options like RRSPs. Our plan would also accommodate low-income Canadians by doubling the current yearly income exemption on CPP contributions (to $7000). Our plan offers a better minimum pension to everyone. CPP benefits are indexed, secure, and portable across jobs. Workers wouldn’t fear losing their pensions given the misdeeds of Bay Street and Wall Street.

This reform will benefit younger workers most, as they would pay higher CPP contributions through more of their worklife. That’s why our plan for the CPP is about preparing for the future, so the next generation of workers can count on a dignified retirement.

How our CPP Plan Would Work:

We propose a doubling of the Canada Pension Plan benefits on a pre-funded basis.

The costs here are modest: As Bernard Dussault confirms, future CPP benefits can be doubled if current CPP premiums are increased by roughly half (an additional 3% of salary for workers and employers). This modest increase offers a huge boost because of the CPP’s size and economies of scale.

How this increase would be phased in: This would be phased in over a seven-year period like CPP reforms in the 1990s.

Low-income workers would be accommodated: To reduce the impact of this increase on low-income workers, we also propose doubling the current “Year’s Basic Exemption” threshold that allows low-income workers to earn income without paying CPP premiums (to $7,000 per year from $3,500 per year). The results of our CPP plan are impressive: Our plan would effectively double the average earnings replaced by CPP pension benefits, to a maximum (in current dollars) of $1,635 per month.

Why This is a Good Idea

Canadians would have more pension security: They would no longer fear losing their pension savings to higher inflation, stock market shenanigans, or the loss of employment.

This is a pan-Canadian solution to a pan-Canadian problem: Some provinces have suggested their own solutions to address pension concerns, but these initiatives won't suffice. Worker mobility between provinces is a major concern, and the CPP's scope is capable of dealing with this issue. The CPP's framework can't be matched by any provincial or regional solution.

This prepares us for the future: Young and future workers would benefit the most from CPP expansion given they would make more CPP contributions at a higher rate. In this way, expanding the CPP is about preparing for the future, and leaving behind a better system for our kids.

Can we afford to do this?

Yes. In fact, we can't afford not to do this. If we don't expand the CPP, the cost of widespread poverty in retirement will be far worse. We either pay modestly now or pay far more later. Remember, many big business lobbyists claimed the sky would fall when CPP premiums were increased in the 1990s, and it didn't. Ignoring the fearmongers was the right move then, and it's the right move now.

Won't this hurt low-income workers and small business?

No. Leaving in place an insecure and inadequate pension system is far more damaging. Low-income workers will be accommodated through a higher limit on income that is exempt from CPP premiums, and small business will be helped by customers with more to disposable income to spend in retirement. Also, there is no RRSP available for small business owners to purchase that can match the CPP. The CPP is an affordable, inflation-protected, portable, defined benefit pension plan that offers real pension security. Small business owners will benefit personally from an expanded CPP, and they will also be able to retain employees through this enhanced pension coverage.

I don't want higher CPP premiums on top of what I currently pay into my workplace pension.

Because the vast majority of workplace pensions are "integrated" with CPP benefits, any increase to CPP premiums means you're paying less into your workplace plan.
The result: you get the same pension income, just more of it from the CPP. And remember, the CPP is far more secure than many workplace pensions. Among other things, it is indexed to inflation, portable across jobs, and generous for years of "low earnings". Also, because workplace pensions will be paying out less under an expanded CPP, money could be available to improve workplace pension benefits (or other aspects of compensation). In other words, an expanded CPP improves the position of unions at the bargaining table.