Determinants of the Evolution of Workplace Pension Plans in Canada

by

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Introduction

This study analyzes the determinants of the evolution of workplace pension plans in Canada, with a particular emphasis on the period since the mid 1970s.

The introduction describes some of the basic features of workplace pension plans in order to make the discussion of their evolution in the second section of the study more comprehensible. The second section assesses the role of workplace pension plans as an income source for Canadian seniors. It looks at the participation of Canadian workers in workplace pension plans through time. It also documents the increased relative importance of defined contribution (DC) plans versus defined benefit (DB) plans, as well as other changes in pension plans over time.

The third section of the study reviews some of the analytic literature on pension plan coverage in Canada, while the fourth section describes recent financing issues faced by workplace pension plans in Canada, with a particular focus on the financing problems of DB plans. The fifth section provides an insight into the views of informed key stakeholders on issues facing workplace pension plans.

Throughout the first several sections, especially in the second and third sections, comments are offered on key influences that have shaped the evolution of workplace pension plans. The sixth section of the study focuses attention on the key determinants or influences and offers some thoughts on future developments with respect to workplace pension plans in Canada.

Historical context

The first organized pension plan in Canada was established by the Government of Canada (usually referred to as the federal government) for its employees in the late nineteenth century. In the following years, a number of provincial governments established pension plans for their employees as did a number of large private sector employers, especially in the financial and railroad sectors [Bryden 1974]. However, the progress in setting up workplace pensions was slow, and even by 1938 there were only 615 formal pension plans in existence covering 265,000 employees [IRC 1938].

From the start of the twentieth century there had been calls for the establishment of public pension plans in Canada. The trade union movement was in the forefront of this campaign. However, at the time, the prevailing view of legislators was that provision for old age was primarily an individual and family responsibility. If additional help were needed, it should be provided by churches, charitable organizations and municipalities. However, continuing calls for old age pensions and an unusual set of political circumstances led the federal government to adopt legislation in 1927 under which it would provide financial support to provincial governments that provided means-tested old age pensions. By the mid 1930s, all provinces had a means-tested plan in place [Bryden 1974]. Even so, pensions were in a rudimentary state of development up to the time of the Second World War.
Following the war, events unfolded quite rapidly with respect to both workplace pension plans and public pensions. Unions grew rapidly and took up the bargaining of pensions as a major collective bargaining priority during the immediate post-war period. By 1960, there were 8,920 plans in place covering 1,863,000 members. By 1965, these numbers had grown to 13,660 and 2,346,000. By 1974, there were 15,853 workplace pension plans in place, covering 3,424,000 members.

In the domain of public pensions, the means-tested program, which had operated since 1927, encountered more and more public criticism and was converted to a uniform flat-rate benefit program called Old Age Security (OAS) in 1952. OAS pays benefits based on age and years of residence in Canada. In its early period, OAS was financed by a designated tax and was payable at age 70. Over the years, the age of eligibility was lowered to 65; OAS came to be financed out of the general tax revenues of the federal government and benefits became price indexed quarterly.

In 1966, the federal government and the province of Quebec launched mandatory earnings-related pension programs called the Canada and Quebec Pension Plans (C/QPP) that provide retirement, disability, and survivor pensions and lump-sum death benefits as well as benefits for the children of deceased and disabled contributors. These programs were designed to provide retirement benefits amounting to 25 percent of pre-retirement earnings, but only on earnings up to the average industrial wage. Although the age of eligibility for retirement benefits was originally set at 70, it was soon reduced in annual decrements of one year to 65.

In 1967, the federal government established an income-tested program for low-income seniors called the Guaranteed Income Supplement (GIS). It was originally conceived as a temporary measure that would compensate the seniors of the day for the fact that they would not be eligible for benefits from the C/QPP. However, over time it came to be preferred over the OAS as a way of making additions to public pension programs because it was ‘better targeted’ to those in need. GIS benefits for low-income seniors are now larger than OAS benefits.

In the following section of this study, the evolution of workplace pension plans over the period since the mid 1970s is documented in detail. This is not the case with respect to public pensions. Thus, two points about their future evolution should be captured here. First, the universal nature of the OAS was effectively ended in 1989 when a surtax was imposed on OAS recipients with income above a threshold amount that was barely 1.25 times average wages and salaries. The surtax amounts to 15 percent of income above the threshold until it equals the full amount of an OAS pension. Second, a number of reforms were made to the C/QPP in the mid 1980s and again in the mid 1990s. One of the reforms of the mid 1980s was to make actuarially reduced C/QPP retirement benefits available from age 60 to 65, and actuarially increased benefits available from age 65 to 70. The increments and the decrements are 0.5 percent per month in either direction from age 65.

Canada’s public pension arrangements are modest by international standards. This is evident in both the actual amounts of public pension benefits paid currently [OECD 2001] and in projections of the benefits that will be available in the future from existing arrangements [OECD 2005b]. However, the combination of the flat-rate OAS, the income-tested GIS and the low earnings cap of the C/QPP mean

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that there is quite strong public pension protection for persons with low earnings before retirement and low income in retirement.

However, persons with moderate to high earnings before retirement are not likely to be able to maintain their standard of living in retirement based on what is available from public programs. The OAS provides the equivalent of 14 percent of average wages and salaries, and the C/QPP only 25 percent of pre-retirement earnings. An individual with no other source of retirement income would also be eligible for a small amount of GIS.

Although these percentages are higher for persons with below-average earnings (and lower for persons with higher earnings), there is still a large gap to be filled by workplace pension plans and individual savings if living standards are to be maintained in retirement. A retiring worker with average earnings can expect about 40 percent of pre-retirement earnings from the OAS and C/QPP. This percentage declines proportionately as earnings rise. It should be noted too that the gap will grow if there is strong growth in real wages and salaries because OAS is only price indexed. This has not been a problem over the past 25 years because average real wages and salaries in Canada have not grown.

The fact that there is a big gap to be filled by workplace pension plans and individual savings is not an accidental fact; it is a desired outcome sought through public policy choices. In the early 1960s when the Canada and Quebec Pension Plans were being debated and created, and again in the early 1980s at the conclusion of a prolonged debate on the future of Canada’s retirement income system, the governments of the day limited the size of the C/QPP to leave ample room for private solutions to pension needs. An explicit preference was declared for a highly regulated private pension sector versus a larger role for the C/QPP [LaMarsh 1968; Simeon 1973; Finance Canada 1984].

**The initiation and evolution of individual workplace pension plans**

The decision to create a workplace pension plan is usually taken by an employer for business reasons. Pension plans are regarded as an effective method of recruiting and retaining employees, and they permit an orderly turnover of personnel without having to impose rigorous performance testing, demotions and dismissals, all of which may damage morale. On the other hand, the employer has to be willing and able to accept the cost of required pension contributions and, in the case of defined benefit (DB) plans, the financial risks. In addition, the employer has to have the administrative capacity to operate the plan and, again, this is more onerous in the (DB) environment. Generally speaking, smaller employers have preferred defined contribution (DC) plans as a way of minimizing financial risks and administrative burdens.

The decision of employers to establish workplace pension plans is often described as voluntary. This is appropriate, in the sense that there is no legal obligation on employers to do so. However, employers are often responding to pressures in the labour market, although these may vary by industry and type of employee. Furthermore, where the workplace is unionized, the establishment of a
A workplace pension plan may result from collective bargaining demands. Moreover, even where an employer has established a pension plan on its own initiative, it is likely that once the workforce is unionized, the plan’s future evolution will reflect collective bargaining with the trade union. In fact, once the existence of a pension plan for unionized employees is mentioned in a collective agreement, it cannot be changed without the concurrence of the union. However, it is important to bear in mind that only one third of Canadian employees are union members, and a comparable number are covered by collective agreements [Jackson 2005].

Most workplace pension plans in Canada are established for all employees of an employer. As of 2004, this is true of 48.1 percent of all plans and 72.0 percent of all plan members. However, there are two important exceptions to this general rule. First, there are, and have been for many years, a significant number of plans set up exclusively for unionized employees at a particular workplace or workplaces. In 2004, this was true of 6.4 percent of all plans and 14.4 percent of all plan members. These percentages had changed very little over the period since the mid 1970s.

The other exception to the general rule of one plan for all employees consists of plans set up for executive personnel. These have grown rapidly over the years, especially in the private sector. By 2004, they accounted for 25.2 percent of all pension plans in Canada, and 43.9 percent of all DB plans in Canada. Not surprisingly, their total membership is only 0.9 percent of all DB plan members. It should be noted as well that executives will often also participate in what are known as supplemental executive retirement plans (SERPs). These are not registered with either the tax or regulatory authorities. They are set up for executive staff whose earnings are at a high enough level that they run into limits under the Income Tax Act on the maximum tax sheltering that is available for workplace pension plans. Supplemental executive retirement plans are common in both the public and private sector and are financed on either a pure pay-as-you-go basis or on a book-reserve basis.

An inference that would be quite appropriate to draw from the foregoing is that employers often sponsor a number of plans for different groups of employees. In a recent survey of chief financial officers of Canadian plan sponsors conducted by the Conference Board of Canada and other organizations, 49 percent had three or more Canadian pension plans and 21 percent had six or more plans.

Although workplace pension plans typically are put in place and evolve in the manner just described, two exceptions to this general pattern are worth noting.

In negotiating workplace pension plans, unions have shown a general preference for DB plans. However, early on their experience in bargaining pension plans, unions discovered that in some sectors of the economy it is very difficult to negotiate DB plans with individual employers because of the presence of one of two conditions: There may be a large number of small employers, so that it is impractical to establish a DB plan with each one, or the employment relationship with individual employers is transient. The construction industry provides a classic example of both problems. In these situations, unions initiate the creation of target-benefit multi-employer pension plans (MEPPs) which are hybrids of DB and DC plans.
In a multi-employer pension plan, unions negotiate a rate of employer contribution to a pension fund that will provide benefits to union members in all of the unionized workplaces in the industry within a specified geographic area. Employer financial obligations are limited to contributing at the agreed rates. In this respect, the scheme is like a DC plan. The plan will be governed by a board of trustees that will be made up entirely of union nominees or a mix of union and employer nominees. Working on the advice of a plan actuary, the board of trustees will establish a target-benefit amount that will be paid for each year of service. The target amount will reflect the contribution rate, the age and gender characteristics of the plan membership, the benefit structure of the plan (e.g. retirement age; presence of survivor benefits), and the extent to which the plan is providing benefits based on both past and future service.

These plans are sometimes referred to as ‘target-benefit’ multi-employer pension plans because the boards of trustees typically have one power that is not normally available in a DB plan: Benefits based on both past and future service can be reduced if a plan is in financial difficulty. Normally, DB plans can only reduce benefits based on future service. However, because the multi-employer pension plans do not have recourse to additional special payments from employers, they are allowed to reduce past service benefit accruals.

The other exception to the general pattern of the emergence and evolution of workplace pension plan described above relates to the public sector. Generally speaking, the pension plans for employees of the federal and provincial governments have been established through the adoption of laws. Moreover, the collective bargaining laws that pertain to employees of these two levels of government have usually excluded pensions from the realm of collective bargaining. However, in practice, the parties to collective bargaining in the public sector having increasingly carried on bargaining on pension issues and, in some cases such as the federal government, this has been facilitated by a reasonably effective advisory committee structure.

The regulatory and tax environment of workplace pension plans

The design and operation of workplace pension plans have been strongly influenced by both regulatory laws and rules under the Income Tax Act. With respect to many of the benefit design issues in DB plans, the provisions of the regulatory laws are the most common provisions of DB plans.

The jurisdictional responsibility for regulating workplace pension plans in the private sector in Canada is a derivative of the right to regulate the industry in which plan members work. Thus, the federal government has responsibility for pension regulation in nationally regulated industries such as banking, communications, international and inter-provincial transportation, and international and inter-provincial trade. The provincial governments are responsible for pension regulation that applies to plans in all other industries. All provinces except Prince Edward Island have in place regulatory laws, commonly known as pension benefit laws. The jurisdiction that regulates the most Canadian pension plans is the province of Ontario, where roughly 40 percent of Canadian plans are registered. The regulatory authority of the federal government applies to about 10 percent of Canadian pension plans.
The presence of 10 jurisdictions in this field is potentially awkward. However, there are enough substantive similarities in the regulatory laws that it is relatively easy to describe them in a generic way, as will be done below. Where there are important differences in the laws, they will be noted. The regulatory laws in Canada have undergone two major articulations, the first in the mid to late 1960s, and the second in the late 1980s. What is described below generally reflects the 1980s state of the laws, with updates as required.

The regulatory laws in all jurisdictions are written as minimum standards legislation to protect the rights of plan members. Workplace pension plans that treat members in a manner that is advantageous compared to the applicable pension benefit law are within the law.

The regulatory laws apply to all private sector pension plans. In most jurisdictions, the laws do not apply to the pension plans that the federal and provincial governments have set up for their own employees. The regulatory laws do not apply to registered retirement savings plans (RRSPs), which are tax-assisted individual retirement savings accounts.

Generally speaking, the regulatory laws are similar in the broadly defined topics they cover; these are:

- plan governance, including the rights of plan members
- benefit provisions
- financing
- investment policy.

In addition, all the pension benefit laws spell out the structure and power of the regulatory authorities and include reporting requirements from the pension plans to the regulators.

**Governance**

All the regulatory laws require a workplace pension plan to have a plan administrator that has overall responsibility for the operation of the plan. The administrator can be an individual, company, board of directors or committee. The administrator is free to delegate various responsibilities but cannot disown responsibility for the overall operation of the plan. An administrator is required by law to establish a pension fund that holds assets at arm’s length from the sponsoring employer(s). The fund trustees typically will be named by the sponsoring employer but must include at least one arm’s length (independent) trustee.

The governance dimension of regulatory laws encompasses provisions designed to protect the procedural rights of plan members. For example, regulatory laws include the right of plan members to request basic plan documents at least once a year. They also include rights of plan members to be notified annually of various aspects of their personal pension situation and to be notified of plan
amendments. Most pension benefit laws also require the creation of pension advisory committees where plan members ask for it. Finally, most pension benefit laws require the approval of plan member for certain uses of pension surpluses and, in the very recent past, for the extension of amortization periods for solvency deficiencies. The regulatory laws vary a great deal among Canadian jurisdictions in terms of the extent to which they recognize unions as representatives of the plan members with respect to these various rights of plan members.

This general account of the way that governance issues are addressed in Canadian jurisdictions does not apply in the province of Quebec in one very important respect. In Quebec a plan administrator must be a committee, and the committee must include one voting member representing each of the active plan members and the retirees, and a non-voting alternate representing the active plan members. In addition, plans are required to have an annual meeting of plan members.

Benefits

As noted earlier in this study, the debate that led to the adoption of new regulatory laws in the late 1980s had as its major focus the question whether it was appropriate to expand the role of the public earnings-related pension programs, the C/QPP. A decision was made not to increase C/QPP benefits in favour of more tightly regulated workplace pension plans and expanded tax support for individual retirement savings arrangements. As a consequence of this decision, Canadian regulatory laws are quite prescriptive in a number of areas.

Canadian regulatory laws now generally include the following requirements:

- if a workplace pension plan is established for a class of employees, membership in the plan cannot be denied for more than two years, and part-time workers with earnings above a (quite high) legislated threshold cannot be denied participation in the plan or in a plan that provides comparable benefits;

- benefit promises to plan members must be vested after two years of plan participation, and plan members with vested benefits who are 10 or more years removed from eligibility for an unreduced retirement benefit must be given the choice of a deferred pension at retirement age or transferring the commuted value to a locked-in individual account or a new employer’s pension plan if the new employer will accept it; in Quebec, vesting is immediate, and in Alberta vesting is required after five years of employment;

- regardless of what a workplace pension plan says about the normal form of a benefit, the payment must include a 60 percent survivor benefit, and this requirement can be satisfied by making an actuarial adjustment to the normal form of benefit; both spouses can jointly waive the survivor benefit in favour of an alternative form of benefit payment; and
• when plan members are within 10 years of qualifying for an unreduced retirement benefit, they must be allowed to choose an actuarially reduced retirement benefit.

**Financing**

The intent of Canadian regulatory laws is to make workplace pension plans self-insuring. With that general objective in mind, regulatory laws in Canada are uniform in requiring two things. First, ongoing contributions must be set at a level that matches the value of newly accruing benefits. Second, if plan assets fall short of plan liabilities, special payments must be made to eliminate the actuarial deficit.

Since the late 1980s, regulatory laws have also required that plans have actuarial valuations prepared once in at least every three years and annually if a plan is showing signs of solvency problems. The valuations determine the required contributions for the coming three years (as the case may be, three calendar years or three financial years). The valuations compare recent experience with projected experience in the last valuation in order to determine gains and losses in the interim. They involve the preparation of two balance sheets on the basis of which decisions are made about the need for special payments. The valuations have to be prepared by a Fellow of the Canadian Institute of Actuaries (CIA). Thus, the manner in which reports are prepared will reflect not only the applicable regulatory law but also the standards of practice established by the Institute.

One of the balance sheets must be prepared on a ‘going-concern’ basis, which assumes that the pension plan will last indefinitely into the future. There is very little prescription in regulatory laws or in the standards of practice of the Canadian Institute of Actuaries that impinges on how going-concern valuations are prepared. The individual actuary has a great deal of discretion, provided that reasonable and consistent economic and demographic assumptions are used. The second balance sheet must be prepared on a ‘solvency basis,’ which assumes that the plan is terminated on the effective date of the valuation. One key difference between the two types of valuation is that a solvency valuation does not include any salary projection, for reasons that are obvious on reflection. More importantly, the solvency valuation must use discount rates that are precisely prescribed in the standards of practice of the Canadian Institute of Actuaries. Solvency valuations are required to use current market yields on long-term bonds to value liabilities.

Another difference between the two types of valuation is that asset smoothing is permitted and common in going-concern valuations. Asset smoothing usually takes the form of recognizing both realized and unrealized capital gains over a period of three years. In the case of solvency valuations, asset smoothing is permitted but is less common.

Solvency valuations were introduced into regulatory laws in Canada in the late 1980s. At the time, they seemed quite unproblematic. Compared to going-concern valuations, they had a ‘built-in cushion’ in the sense that salaries did not have to be projected. In fact, wage and salary growth was so slow at the time and since, that wage growth has been a recurring source of experience gains because it
has remained common to assume 1.5 to 2.0 percent average real wage growth in actuarial valuations. Moreover, at the time yields on long-term bonds were still above the level of the valuation rates of return (discount rates) used in most going-concern valuations. In addition, pension fund assets were growing at an unanticipated rate. What happened when some of these conditions were reversed are discussed in the section of this study titled “Recent pension financing issues.”

The pension benefit laws in all Canadian jurisdictions are designed to make workplace pension plans self-insuring. However, problems can and do arise in the case of plan termination, especially if the termination is the result of bankruptcy. In addition, it is important to note that the jurisdiction that has the most registered plans and plan members – the province of Ontario – has a scheme of pension insurance in place which limits, by degree, losses that plan members might face when a plan is terminated due to the bankruptcy of the plan sponsor.6

In most, but not all, jurisdictions the regulatory laws provide that, in the event of plan termination, the sponsoring employer must contribute to the pension fund enough money to make good on the pensions promised to the plan members. However, when the cause of plan termination is the bankruptcy of the sponsoring employer, bankruptcy law comes into play, and required contributions to pension plans are neither a secured nor a preferred creditor. As a result, it is likely and not just possible that pension assets of the bankrupt employer will not be able to be enhanced by a sale of assets of the bankrupt entity. If plan assets were less than liabilities before the bankruptcy, there is little chance of the situation improving during bankruptcy proceedings.

**Investment**

Generally speaking, the provisions of Canadian regulatory laws regarding pension fund investment have moved from quantitative prescriptions that were generally designed to insure diversity in funds’ investments to a ‘prudent person’ regime. Some quantitative prescriptions have survived in the regulatory laws, such as a prohibition on lending 10 percent or more of the book value of a fund to any single private entity. There are also limitations on real estate and resource holdings, and a limitation of 30 percent of the voting shares of a public corporation that can be acquired by a fund. There are some exceptions to this 30 percent rule.

Canadian regulatory laws also require plans to prepare a statement of investment policies and procedures which specifies such things as asset allocation, expectations regarding rates of return, diversification of the portfolio, liquidity of the portfolio, lending of money or securities, retention or delegation of proxy voting rights, and valuation of assets that are not regularly trade on a public exchange. Statements of investment policies and procedures must be reviewed and approved annually.

Until the spring of 2005, rules under the *Income Tax Act* limited the foreign investments of Canadian pension plans and RRSPs to 30 percent of the assets on a book-value basis. When the limit was eliminated, Canadian pension funds had acquired futures contracts on US stock markets from
Canadian vendors in order to increase their exposure to foreign market returns beyond the 30 percent limit. The fact that the contracts were entered into with Canadian vendors meant that they were not considered as foreign property.

**Tax rules**

Substantial changes were made to Canada’s tax rules governing workplace pension plans and RRSPs in 1990. Prior to that time, separate and largely non-integrated rules existed for DB pension plans, DC pensions plans and RRSPs, with additional rules for members of workplace pension plan who wanted to contribute to RRSPs. In the years prior to the adoption of the 1990 rules, much more scope for tax-assisted retirement savings was offered to members of DB pension plans than was available to members of DC plans or to persons who did not belong to any type of pension plan. The new rules were motivated in large part by a desire to equalize the tax-supported retirement savings under the various types of plan. This was seen, among other things, to create a fairer regime for the self-employed.

As was the case before 1990, tax support took the form of the tax deductibility of employer and employee contributions, and the non taxation of investment income in registered vehicles (pension funds and retirement savings accounts). Benefit payments are taxed as regular income.

However, unlike before, the new system is highly integrated. Everyone starts a tax year with room for tax-sheltered retirement savings that amounts to 18 percent of the previous year’s earnings up to a maximum dollar limit of roughly $100,000 of earnings. What must be deducted from this limit consists of DC contributions made by the employee and his/her employer or an amount that reflects the generosity of their annual benefit accrual under a DB plan. Any residual that is left after deducting these amounts from 18 percent of earnings up to a maximum dollar amount is available for tax—sheltered RRSP contributions. For DB plan members an additional flat dollar among is made available for RRSP contributions. Room that is available for making tax-sheltered pension contributions in a particular year that is not used can be carried forward to future years. In practice, a very small portion of contribution room is used each year [Schembari 2006b].

The tax rules include limitations on various aspects of a DB plan that can be registered for tax purposes. For instance, they establish the most generous defined benefit formula as:

Two percent times years of service times the best three consecutive years’ earnings.

In addition, benefits in 2005 could not exceed $2,000 per year of service; since 2005, this dollar amount has been indexed to average wage increases. The $2,000 figure is a two percent accrual rate on $100,000 of earnings. Since executive pay is often a very large multiple of this amount, it has become common in both the public and private sectors to establish supplementary executive retirement plans which provide benefits on the portion of salaries in excess of the income tax maxima. Supplementary plans operate outside the regulatory framework for workplace pension plans. They may be structured
financially on a book reserve basis and, in some instances, are backed by letters of credit from financial institutions. However, most commonly they operate on a pay-as-you-go basis.

The tax rules also set limits on the retirement age in workplace pension plans. All pension plans and RRSPs must commence payment of benefits by January 1 of the year following a person’s 69th birthday. However, in the case of DB pension plans, lifetime pension benefits cannot begin earlier than:

- age 60 with no service requirements
- 30 years of service with no age requirement
- age plus service equals 80.

Certain hazardous public safety occupations are permitted to have benefits that begin five years before these thresholds. The income tax rules also limit indexing to the cumulative limit in price changes over the retirement period.

Workplace pension plans and registered retirement savings plans

Conceptually, workplace pension plans and RRSPs are distinct registered vehicles for providing retirement income. Workplace pension plans are group pension plans, and RRSPs are individual retirement savings vehicles. In practice, however, they tend to converge in certain respects. For example, in recent years, some employers have created group RRSPs rather than providing a formal pension plan. In practice, this involves contracting with a financial institution to establish RRSPs for individual employees, and the employer contributes to those RRSPs.

In general terms, group RRSPs are broadly similar to DC pension plans. However, there are some differences. DC pension plans are subject to pension benefit laws while group RRSPs are not. Among other things, this means that the requirement to provide a survivor benefit does not apply to a group RRSP, and there is greater scope for employers to decide who will and will not participate in the scheme. In addition, when employees reach retirement age, ‘phased withdrawals’ of assets are more widely available in a group RRSP than is true of a DC workplace pension plan. Moreover, once a contribution is made on behalf of a plan member in a group RRSP, it vests immediately in the plan members and can be withdrawn prior to retirement for reasons unrelated to retirement. Aside from the fact that some of these differences may be reasons for participating in a group RRSP, a DC plan may be able to operate with greater administrative efficiency.

It is worth noting too that the rules in place governing benefits on termination of employment mean that DB plan promises are regularly turned into DC accumulations for individual plan members who leave their employer before retirement age.
The evolution of workplace pension plans

This section examines some of the most important aspects of the evolution of workplace pension plans. In particular, it discusses the evolving role of pension plans as a source of income over the latter part of the twentieth century; overall participation in pension plans; the shift from DB to DC coverage; and a number of qualitative changes in pension plans.

Workplace pension plans as a source of income

Over the latter part of the twentieth century, the incomes of Canadian seniors improved markedly. Real incomes of senior households increased by about 50 percent, the income gap between senior and non-senior households narrowed, and the incidence of low income among seniors declined significantly, although it remained an issue for single women seniors. This rapid improvement tailed off somewhat at the end of the century.

Two sources of income were maturing through the end of the century, and income from these sources grew particularly rapidly. One was the Canada and Quebec Pension Plans, which were introduced in 1966, paid ‘full’ retirement benefits since 1976 and provided benefits to an increasing portion of seniors through the end of the twentieth century. The other source of retirement income that was maturing over this period was, in the typology of the World Bank, ‘third pillar’ income – i.e., income from workplace pension plans and RRSPs. The share of total income of seniors coming from these sources grew significantly, while the share of income coming from employment and investments declined.

Table 1 provides data on the total incomes of senior households for five selected years between 1973 and 2000 (1973, 1981, 1989, 1996 and 2000), as well as data on incomes from workplace pension plans and RRSPs. The table also provides the same data for individual men and individual women for the last four of those years. It should be noted that, while the data includes income from workplace pension plans and most of the income from RRSPs, the data is still dominated through the end of the period by income from workplace pension plans.

As can be seen in Table 1, the percentage of senior households receiving third pillar income has grown substantially, from only 27.9 percent of senior households in 1973 to 66.3 percent in 2000. The real value of pension incomes (income measured in constant 2000 dollars) almost doubled from $8,394 in 1973 to $15,881 in 2000. The share of total income from this source almost trebled from 10.4 percent to 29.4 percent.

At the individual level, it is clear that workplace pension plans have historically been more important for men than for women. In 1981, senior men were twice as likely as senior women to have income from a workplace pension plan (40 percent versus 18 percent). The percentage of senior men’s total income received from workplace pension plans was also twice that of senior women (16 percent...
Table 1
Workplace pension plans and RRSPs
as sources of income for Canadians aged 65 and over, selected years

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<tr>
<td>Percent with pension income</td>
<td>27.9</td>
<td>35.1</td>
<td>45.4</td>
<td>53.2</td>
<td>66.3</td>
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<td>Pension income as a percent of total income</td>
<td>10.4</td>
<td>10.5</td>
<td>14.8</td>
<td>22.3</td>
<td>29.4</td>
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<td>Average amount of pension income</td>
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<td>$8,170</td>
<td>$10,632</td>
<td>$13,351</td>
<td>$15,881</td>
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<td>Average amount of total income</td>
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<td>$27,380</td>
<td>$32,677</td>
<td>$31,834</td>
<td>$35,363</td>
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<th>Women seniors</th>
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<tbody>
<tr>
<td>Percent with pension income</td>
<td>17.6</td>
<td>17.6</td>
<td>34.2</td>
<td>47.9</td>
<td></td>
</tr>
<tr>
<td>Pension income as a percent of total income</td>
<td>7.8</td>
<td>11.6</td>
<td>17.4</td>
<td>31</td>
<td></td>
</tr>
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<td>Average amount of pension income</td>
<td>$6,349</td>
<td>$7,284</td>
<td>$8,490</td>
<td>$8,830</td>
<td></td>
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<tr>
<td>Average amount of total income</td>
<td>$14,372</td>
<td>$16,912</td>
<td>$16,883</td>
<td>$18,315</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Men seniors</th>
<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
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<tr>
<td>Percent with pension income</td>
<td>39.9</td>
<td>48.3</td>
<td>57.4</td>
<td>68.1</td>
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<tr>
<td>Pension income as a percent of total income</td>
<td>16.0</td>
<td>21.3</td>
<td>31.3</td>
<td>40.2</td>
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<tr>
<td>Average amount of pension income</td>
<td>$9,227</td>
<td>$12,136</td>
<td>$14,950</td>
<td>$15,169</td>
<td></td>
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<tr>
<td>Average amount of total income</td>
<td>$23,051</td>
<td>$27,458</td>
<td>$27,458</td>
<td>$28,223</td>
<td></td>
</tr>
</tbody>
</table>

Note: All dollar amounts are in constant 2000 dollars.

versus 8 percent). By 2000 the gender gap had narrowed substantially, but a significant gap remained. Among senior women, 48 percent were in receipt of pension income, as was the case with 68 percent of senior men. Income from workplace pension plans had come to account for 31 percent of senior women’s income and 40 percent of senior men’s. Pension coverage data discussed below suggest that this gap will continue to narrow.

There is one thing about income from workplace pension plans that is not evident from Table 1 that should be noted. Within the senior population, such income tends to be concentrated among those with higher income. For senior men in 2000, more than 80 percent in deciles five through 10 received income from workplace pension plans, as did women in deciles seven through 10. In senior women’s decile six, 78 percent received pension income. By contrast, only one in five women in the lowest three deciles received pension income, as was the case in men’s deciles one and two. Income from the Canada/Quebec Pension Plans is more widely received by the senior population, but in smaller amounts.

It should be noted that while the data in Table 1 focus on the income of persons aged 65 and over, third pillar income is more important compared to income from publicly administered programs in the period prior to age 65. Prior to age 65, the universal flat-rate OAS pension is not available, though a program similar to the GIS is available to some persons with low incomes aged 60 to 65. C/QPP retirement benefits are available at age 60 on an actuarially reduced basis, and it is common for persons to start to draw benefits prior to age 65.

### Pension plan coverage through time

As was noted earlier in this study, workplace pension plans were in a rudimentary state of development at the start of the Second World War and only became widespread following the war. By 1960, there were 8,920 plans in place covering 1,863,000 workers, and by 1965 the comparable numbers were 13,660 and 2,346,000. By 1974, there were 15,853 plans with 3,424,000 members. In 1974, Statistics Canada, Canada’s national statistical agency, put in place an ongoing program of data collection on workplace pension plans. The data source is known as the Pension Plans in Canada (PPIC) database. It is the most widely cited and best known source of data on workplace pension plans, and data from this source will form the starting point of this discussion of coverage.

The main issue to be addressed here is the numbers of persons who belong to workplace pension plans. However, it is first worth commenting briefly on the number of plans.

As was noted above, by 1974 there were 15,853 workplace pension plans in Canada. The number of plans has remained quite stable since that time. However, two exceptions should be noted. First, there was a brief period in the middle of the 1980s when the number of small DC plans in Canada mushroomed from 3,200 in 1982 to 8,500 in 1985. By 1994, the number of these plans had contracted again to 3,200. In addition, between 2001 and 2002, there was a decline of nearly 1,500 workplace pension plans, from 15,355
to 13,861. This is an unusually large decline for a single year. However, over the following two years the total number of pension plans grew again to 14,777 – still somewhat below the 1974 number.

While the number of workplace pension plans in Canada was quite stable over the period from 1974 onward, the total number of plan participants continued to grow, as shown in Figure 1. In 2004, there were 5,590,000 members in pension plans in Canada, which is a 63 percent increase over 1974. The growth in membership was quite steady over the entire period, but there were observable declines in membership in the recessions of the early 1980s and early 1990s.

In the former case, the decline was short lived and involved only about 100,000 members; in the latter case, the decline lasted for six years and involved more than 200,000 members. While it is appropriate to describe the growth of plan membership as steady, the aggregate hides some important changes in the composition of the membership. In this regard, the most notable changes relate to the gender composition of plan membership, and in the public sector versus private sector balance in plan membership.

In 1974 when the PPIC data series begins, there were 2.7 male plan members for every female. Although male membership was greater than female membership throughout the period, by 2004 there were 1.1 male members for every female. This reflects continued growth in female membership over the entire period, with particularly rapid growth occurring in the late 1980s and early 1990s. By contrast, male membership reached a level in 1982 that it has not achieved since, though this level of male membership was almost achieved again in 1992.

![Figure 1](image-url)

**Figure 1**

Number of members of workplace pension plans, by sex, 1974-2004

(a) Public and private sectors combined

<table>
<thead>
<tr>
<th>Year</th>
<th>Men (Thousands)</th>
<th>Women (Thousands)</th>
<th>Both sexes (Thousands)</th>
</tr>
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<tbody>
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<td>2,953</td>
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<td>4,193</td>
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<tr>
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<td>3,098</td>
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<td>3,181</td>
<td>1,525</td>
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<td>4,660</td>
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</table>

(Numbers in thousands)
### (b) Public sector only

<table>
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<th>Both sexes</th>
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</thead>
<tbody>
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<tr>
<td>04</td>
<td>1,121</td>
<td>1,459</td>
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</tbody>
</table>

Source: Author’s calculations based on data from Statistics Canada [2006a].

### (c) Private sector only

<table>
<thead>
<tr>
<th>Year</th>
<th>Men</th>
<th>Women</th>
<th>Both sexes</th>
</tr>
</thead>
<tbody>
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<tr>
<td>04</td>
<td>1,890</td>
<td>1,101</td>
<td>2,949</td>
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</tbody>
</table>

Source: Author’s calculations based on data from Statistics Canada [2006a].
The number of women in workplace pension plans in the public sector was 1.4 times that in the private sector in 1974 and in 2004. However, in absolute numbers, women have outnumbered men in public sector plans since 1990, while in private sector plans they are less than two thirds of the number of men. In her detailed review of pension plan data, Schembari [2006a] attributes the relatively strong growth in female plan membership to the increased labour force participation of women, legislative changes that improved the access of part-time workers to pension plans and strong employment growth for women in sectors of the economy that have high plan coverage (e.g., health and education).

Growth in the overall numbers of plan members has been somewhat reassuring. However, it is a matter of some concern that growth has not been achieved in relation to the numbers of persons employed. As can be seen in Figure 2, the percentage of paid workers who belong to workplace pension plans had reached a level in the early 1980s that has not been exceeded since that time, with just over half (52.3 percent) of paid workers being members of such plans in 1983. Since that time, the erosion has been quite steady, and by 2003 only 39.4 percent of paid workers were members of pension plans.

Again, there is a substantial gender dimension to the change in coverage. In the late 1970s, men were much more likely than women to belong to a pension plan; 52.2 percent of employed men and 36.0 percent of employed women did so. However, by 2003, the gender difference was minuscule; 39.4 percent of employed men and 39.1 percent of employed women belonged to pension plans.

![Figure 2](coverage_of_paid_workers_by_workplace_pension_plans_by_sex_1977-2003.png)

Source: Tamagno [2006].
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Again, there is a substantial gender dimension to the change in coverage. In the late 1970s, men were much more likely than women to belong to a pension plan; 52.2 percent of employed men and 36.0 percent of employed women did so. However, by 2003, the gender difference was minuscule; 39.4 percent of employed men and 39.1 percent of employed women belonged to pension plans.

It is important to think about coverage in relation to employed persons. After all, one of the main purposes of a pension plan is to replace pre-retirement earnings in retirement. However, it is also worth examining pension coverage in relation to the total adult population. Table 2 provides data on the total population peaked at 29 percent but remained steady at 27 percent in 2004. The relative stability of the ratio of plan members to the total population compared to the clear decline in the ratio of plan members to employed persons reflects the fact that, over the period from the late 1970s to the early 2000s, there has been a significant increase in the employment-to-population ratio.

Table 2 accentuates the differences in the male and female participation in workplace pension plans over time. The percentage of the adult female population participating in pension plans nearly doubled over the period from 1974 to 2002. Male participation declined by one quarter from a peak in the late 1970s and early 1980s.

As will be discussed more fully later in this study, a disappointing aspect of the PPIC data is that it does not include much information on the social and economic characteristics of pension plan members. For the most part, insights in this area have to be gleaned from other data sources. However, one thing we can learn from the PPIC data is the province in which PPIC members work. In this regard, there is a clear tendency for the provinces that have had the greatest expansion in employment to have the greatest decline in the portion of the employed labour force covered by a workplace pension plans. Thus, if one expresses the portion of the employed population that belongs to a pension plan in 2003 as a multiple of the same portion in 1977, the provinces with the most rapidly growing employment – Alberta, British Columbia and Ontario – had declines in coverage rates to 0.84, 0.75 and 0.80 respectively. Employment did not grow as rapidly in Quebec as it did in these other provinces, but Quebec remains a very important part of the total Canadian labour force, especially for francophones; its ratio of 2003/1977 coverage rates was 0.89. By way of contrast, coverage rates increased in a number of slow-growth provinces such as Manitoba, Newfoundland and Labrador, Prince Edward Island and Saskatchewan.
Table 2
Members of workplace pension plans as a percentage of the population aged 18-64, 1974-2004

<table>
<thead>
<tr>
<th>Year</th>
<th>All members as a percentage of the total population</th>
<th>Male members as a percentage of the male population</th>
<th>Female members as a percentage of the female population</th>
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<td>2004</td>
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Source: Author’s calculations based on Statistics Canada [2006] and Statistics Canada Census Population data and between-census population estimates.

DB/DC balance through time

In Canada as in a number of other countries, there has been a shift from DB to DC pension plans, although this shift has not been as dramatic in Canada as elsewhere. In Figure 3, the steady nature of this shift over the period since the mid 1970s is evident. Yet even in 2004, more than 80 percent of plan members are in DB plans. However, more than half of the decline in DB membership occurred in the relatively brief period since 1996.

With respect to the shift from DB to DC plans, there are important differences between the experience of the public and private sectors. The public sector always weighted more heavily to DB plans and, in 2004, more than 93 percent of public sector plan members were in DB plans compared to 99 percent in 1974. That said, the glacial erosion of DB coverage in the public sector is more perceptible in the recent past.
In the private sector, the shift away from DB plans is a stronger tendency. In 1974, 91 percent of private sector plan members were in DB plans and, by 2004, DB plan membership accounted for only 74 percent of the total. More than half of this relative decline in the importance of DB plans occurred after 1994. Indeed, as late as 1984, the DB share of total private sector pension plan membership was as high as it was in 1974.

The choice of DC plans over DB plans by employers plan sponsors has tended historically to reflect the size of the employment base of the plan sponsor. Smaller employers have tended to favour DC plans because of the predictability of required contributions and their comparative administrative simplicity. While the general pattern of larger plans being DB schemes and smaller ones DC schemes persists, there have been some interesting sub-patterns over the past 30 years [Schembari 2006a].

The number of very large DB plans (1,000 or more members) has remained stable, and in recent years there has been surprisingly strong growth in very small DB plans (those with one to nine members). These are likely the executive-only plans referred to earlier in this study. The number of plans with 100 to 999 members increased from 1,500 to 2,000 between 1974 and 1980, remained above the 2,000 level into the beginning of the 1990s and declined to just above 1,500 by 2004. The number of such plans ended up where it started. The DB plan size that showed the greatest tendency to decline over the years was plans with 10 to 99 members. There were more than 3,500 of these plans in 1974, and that number held up until 1980. After 1980, there was a nearly linear decline in the number of these plans until 2004, when there were 1,500 of them.

The pattern of change in the number of DC plans by plan size is not exactly a mirror image of change in the number of DB plans. Very large DC plans (1,000 or more members) remained few in number over the entire period, growing from zero to 120 over the period from the mid 1980s until 2004. Very small DC plans (those with one to nine members) followed an erratic pattern that includes the dramatic increase in their number in the mid 1980s followed by an equally dramatic decline. Thus in 1994, the number of such plans was the same as it was in 1982 before the dramatic increase began. However, what is somewhat surprising is that their number continued to drift downward after 1994, from roughly 3,500 to less than 2,000. This may reflect the substitution of group RRSPs.

The clearest trends with regard to the growth of DC plans by size relate to mid sized plans. DC plans with 10 to 99 members grew especially strongly over the 1980s. By 1988 there were 4,000 such plans, and they remained at roughly that number until 2004. DC plans with 100 to 999 members were less numerous than smaller plans but grew steadily over the period, and there were just over 1,000 of them in 2004. This is a very substantial multiple of the number of very large plans.
Figure 3
Percent of plan members in DB and DC plans, 1974-2004

(a) Public and private sectors combined

(b) Public sector only

(c) Private sector only

Source: Tamango [2006a].
Qualitative aspects of the evolution of workplace pension plans

The decline in pension plan membership in relation to the number of employed persons and the tendency for membership to shift from DB to DC plans are the most important and widely acknowledged changes in pension plans in recent years. However, there are at least five other areas of change that should not pass without notice:

(1) As was noted earlier in this study, the regulatory reform of the late 1980s required workplace pension plans to provide a number of new benefit protections for plan members in areas such as eligibility for plan membership, benefits on termination of employment, survivor benefits and early retirement benefits. It is noteworthy that these issues were not dealt with adequately without regulation, even in unionized environments.

(2) With the introduction of the C/QPP in 1966, the emphasis on the provision of pension benefits in large plans shifted, by degree, from providing lifetime benefits to providing early retirement benefits. Normal retirement age in workplace pension plans is overwhelmingly 65, but it has become common in large plans to have other conditions under which ‘unreduced’ retirement benefits are paid at an earlier age [Statistics Canada 2006]. Thus by 1974, when PPIC data first became available, 300 pension plan with 30 percent of plan members provided unreduced benefits prior to age 65 [Statistics Canada 1976]. Ten years later, 7 percent of pension plans with 49 percent of plan members provided for unreduced retirement benefits prior to age 65 [Statistics Canada 1986].

(3) During the period leading up to the regulatory reforms of the late 1980s, there was active discussion of requiring some version of mandatory pension indexing. Indeed, this had been recommended by a committee of Canada’s pension regulators (the Canadian Association of Pension Supervisory Authorities or CAPSA). In fact, there has been no regulatory obligation to provide either price or wage indexation of pension benefits in pay.

In practice, the price indexation of pensions in pay has remained an exception rather than rule. Price indexation is common in large public sector plans and has been since the late 1970s. By 2004, 80 percent of public sector plan members belonged to plans with some degree of automatic price indexation. However, in the private sector, price indexation remains uncommon, with only 20 percent of plan members enjoying any degree of formal price indexation. It should be noted that rules under the Income Tax Act limit annual adjustments to price movements, so wage indexation is effectively prohibited and few plans provide for the indexation of deferred pension benefits.

As retirement periods increase with life expectancy, the degree of adjustment to price changes becomes increasingly important. Given their greater life expectancy, indexation is somewhat more important for women than for men.
(4) Well into the 1970s, it was common for DB pension plans to provide benefits based on a plan member’s earning over their entire working career (i.e., through a career average earnings plan). In 1974, 66.4 percent of all DB plans were of this sort, and 21.7 percent of all DB plan members belonged to this type of plan. However, the combination of inflation and strong real wage growth in the 1970s revealed the weakness of this plan design in replacing pre-retirement earnings. Thus, by 1986, only 37.7 percent of all DB plans were of this type, and 12.8 percent of all plan members belonged to this type of plan. The declining role of career average pay plans was filled by best average pay plans.

(5) Another noteworthy change in workplace pension plans occurred in the 1980s. It had been common until that time for small plans, both DB and DC, to purchase fully insured pensions from insurance companies. As late as 1984, 45.6 percent of pension plans were of this type. The fact that they were small plans means that only 5.8 percent of plan members belonged to plans of this type. However, by 1986, only 13.0 percent of plans with 1.4 percent of plan members were fully insured.

**Secondary literature on pension plan coverage**

As noted earlier in this study, while the PPIC database affords some valuable insights into workplace pension plans, one of its shortcomings is that it offers little insight into the social and economic characteristics of plan members. However, a number of assessments of pension plan coverage based on other data sources help to address this issue. Many of the assessments draw on databases that include little qualitative information about the pension plans to which persons belong, and many of the databases are derived from surveys that are not conducted on a regular basis. In addition, many have no historical dimension to them. Despite these limitations, there are several secondary analyses of pension plan coverage that enrich the understanding that can be gleaned from the PPIC database on who belongs to workplace pensions in Canada.

**Lipsett and Reesor: Employer-sponsored pension plans – Who Benefits?**

Lipsett and Reesor [1997] have conducted one of the most complete assessments of who belongs to workplace pension plans (the term ‘employer-sponsored pension plan’ in the title of their paper is a synonym for workplace pension plan). The data with which Lipsett and Reesor work comes from the 1995 Survey of Work Arrangements (SWA). This survey had been conducted on an irregular basis but was abandoned with the launch of the Workplace and Employee Survey (WES). They use both bivariate and multivariate analyses to assess the strength of job characteristics, personal characteristics and wages in explaining pension plan coverage.
The job characteristics of interest include:

- part time/full time
- temporary versus permanent
- union status
- firm size
- public versus private sector
- job tenure
- industry and occupation.

Personal characteristics include:

- province of residence
- education
- age, marital status and presence of dependents.

An important aspect of the SWA is that respondents were asked whether they belonged to a workplace pension plan or a group RRSP. Lipsett and Reesor conclude that the plan coverage rate of 42 percent captured in the PPIC data at that time of their analysis would have been 51 percent if group RRSP membership was added to pension plan membership. This adds 20 percent to coverage, all on the DC side of the DB/DC distinction. Even though there is some evidence that persons overstate coverage in household surveys [Morissette and Zhang 2004], the impact of including group RRSP coverage along with pension plan coverage is likely to be significant.

Lipsett and Reesor summarize their main conclusions on the determinants of coverage as follows:

The major determinants of [pension plan] coverage are found to be unionization and firm size, seniority (as proxied by job tenure), permanent/non permanent job status, part/full-time hours and wages. Secondary determinants of [pension plan] coverage include class of worker (public/private sector), industry, occupation, age, education, province of residence, marital status and presence of dependents.

Lipsett and Reesor suggest that insecurity in employment is likely to reduce one’s chances of a good pension in retirement. Moreover, given the increase in insecure employment at the time of writing, they express concern about pension plan coverage in the future.

Looking beyond their main conclusions, a few specific points are worth mentioning. First, because it is not in their brief statement of conclusions, it is important to note that Lipsett and Reesor found a strong positive effect of earnings on pension plan coverage. Subject to one small caveat, many analyses using tax data have come to the same conclusion. The one caveat that may be required here relates to the fact that Lipsett and Reesor use only four hourly earning categories, the highest of which is $21.00 per hour. Most analyses employ annual earnings data and a larger number of categories at the high end of the earnings scale. They often end up showing higher pension plan coverage rates until the top open-ended earnings category where coverage is
slightly lower than in the next to highest category [Schembari 2006b]. This is a point of contrast with RRSP contributors: the percentage of tax filers contributing to RRSPs increases monotonically with income.

Lipsett and Reesor also note that most of the higher coverage in the public sector can be accounted for by size of employer, unionization and education. In addition, being a part-time worker still reduces the likelihood of pension plan coverage even after the legislative changes of the late 1980s.

For both men and women, lowest coverage rates are found in business and personal services, agriculture, miscellaneous services, wholesale and retail trade, and construction. Highest rates are found in public administration, community services and finance, insurance and real estate. By occupation, female and male experiences tend to differ. Highest coverage rates for women are in teaching, natural and social science, management and administration, other crafts and clerical occupations. For men, material handling replaces crafts as a high coverage occupation. The lowest coverage occupations for women include material handling, transportation, processing, fabricating and machining. For men, lowest coverage occupations include transportation, fabricating, medicine, artistic and other craft occupations.

As a generalization, the personal characteristics tend to weaken quite significantly in the multivariate analysis.

**Morissette and Drolet: The Evolution of Pension Coverage of Young and Prime-Aged Workers in Canada**

Morissette and Drolet [1999] use data from three different household surveys that ask respondents if they belong to a workplace pension plan in order to explore changes in plan coverage rates by age and gender over the period from the mid 1980s to the mid 1990s. The age groups on which they focus are 25- to 34-year-olds (‘young workers’) and 35- to 54-year-olds (‘prime-aged workers’).

The data sources are the Survey of Union Membership (SUM) of 1984, the Labour Market Activity Survey (LMAS) of 1986 to 1990, and the Survey of Labour and Income Dynamics (SLID) of 1993 to 1996. The coverage rates from these data sources are quite similar to those derived from the PPIC for women. However, they do not suggest the same decline in male coverage as shown in the PPIC data.

Morissette and Drolet note that, in their data, coverage rates for young men decline significantly over the period from the mid 1980s to the mid 1990s. Coverage rates remain stable for prime-aged men and young women. Finally, coverage rates increase for prime-aged women. They proceed to explore the role of changes in union status, sectoral and occupational shifts in employment as variables that explain the changes in coverage. Analyses are done with and without taking account of wage changes over the period. A variety of decomposition techniques are used to establish the role of different factors in explaining changes in pension plan coverage over time.
When reductions to wages are ignored, de-unionization and sectoral shifts in employment account for the full extent of the decline in the pension coverage of young men. Introducing a $0.75 per hour wage reduction on a base hourly wage of $11.86 (1984 dollars) reduces slightly the explanatory power of these two factors. In context, it is worth noting that, descriptively, coverage did not drop among unionized young men.

For prime-aged men, the decline in union membership was also a factor, but much smaller than in the case of younger men. Moreover, this smaller factor got smaller again when wages were introduced as an explanatory variable.

As was the case with young men, the coverage of young women was adversely affected by a decline in unionization and sectoral shifts in employment. However, the adverse effects were much smaller for young women than young men. More importantly, these adverse effects were offset by occupational shifts and increased hourly pay.

Prime-aged women are the one group that experienced increased pension plan coverage during the period under review. As was the case with other groups, they experienced the negative influence of a decline in unionization. This negative influence was offset by increased participation in higher coverage occupations. The increased coverage of prime-aged women seems to be related to their advancement toward better paid jobs.

*Morissette and Ostrovsky: Pension Coverage and Retirement Savings of Canadian Families, 1986 to 2003*

Morissette and Ostrovsky [2006] address a number of issues, only one of which will be discussed directly here: coverage by households. By contrast, the analyses of pension plan coverage by Lipsett and Reesor and by Morissette and Drolet, and most of what has been written on pension plan coverage, deal with the coverage of individuals.

Morissette and Ostrovsky use data from the LMAS, SLID and the Longitudinal Administrative Databank (LAD) to assess the coverage of individuals through time. The LAD is an administrative database that includes tax data. It can identify members of contributory pension plans and RRSP contributors since 1986, and all pension plan participants since 1991. The LAD is a very large database that permits the matching of individual records with those of other family members.

In their analysis, Morissette and Ostrovsky focus on young adults aged 25 to 34 and prime-age adults aged 35 to 54. Only opposite-sex family units are considered in their analysis.

Husband and wife families are assigned to one of four groups:

- neither the husband nor the wife contributes to (participates in) a workplace pension plan
- the husband only contributes to (participates in) a pension plan
- the wife only contributes to (participates in) a pension plan
- both the husband and the wife contribute to (participate in) a pension plan.

Given that the LAD only identified members of contributory plans prior to 1991, participation in contributory plans is tracked from 1986 while participation in all plans (i.e., contributory and non-contributory) is tracked from 1991.

No matter which of the two measures (pension plan contributors or all plan participants) and time periods (1986 onwards or 1991 onwards) were examined, there is a small increase in the ‘neither’ category for both prime-aged and young couples. For young couples, there is an increase of nearly four percentage points on the contributory measure from 1986 to 2003, and 3.3 percentage points on the ‘all participants’ measure over the period from 1991. In the case of prime-aged couples, the increases were 2.7 percentage points on the contributory measure and 4.0 percentage points on the ‘all participants’ measure. For the two contributory measures and the young couples all participants measure, the ‘neither’ category peaked in the late 1990s and declined somewhat at the end of the period. Therefore, it would seem that the likelihood of couples having no one with pension plan coverage was at its highest in the late 1990s.

Not surprisingly, in all age and contributory/participation measures there was a decline in ‘husband only’ coverage that is not fully offset by an increase in ‘wife only’ coverage. There is little change in the ‘both’ category. In three of the four clusters by age and contributory/participation, the end-point datum is within a percentage point of the start-point datum. The only exception is in the prime age contributory group, where there is a 2.7 percentage point increase.

Morissette and Ostrovsky include a great deal of data and discussion on coverage by other types of family group (lone parent, individual) and by earnings decile. The most important conclusion from the analysis is that the decline of coverage at the individual level is greater than at the couples’ level. However, as can be seen from the previous paragraphs, there has been some increase in the portion of couples with no pension plan coverage.

**Luchak and Fang: Pensions or Group RRSPs: Patterns of New Plan Adoptions, Establishing Secondary Plans, Terminations and Plan Substitutions**

Luchak and Fang [2005] use the Workplace and Employee Survey (WES) to explore the dynamics of pension coverage by workplace pension plans and group RRSPs. The WES is an establishment survey that has parallel and matching employer and employee components, and it is longitudinal. Luchak and Fang use the longitudinal dimension of the WES to explore changes in the form of coverage at the establishment level from 1999 to 2001. It should be noted that the WES excludes public administration from its survey universe. Luchak and Fang also exclude the natural resource sector. It should also be noted that because the WES is an establishment level survey, the absolute numbers of plan observations tend to be much larger than when plans are the focus of analysis. Presumably, this reflects the presence of multi-establishment plans.
Luchak and Fang identify two things with respect to workplace pension plans and group RRSPs that are particularly striking and that are not evident in other sources. The first is a high degree of change in pension and RRSP coverage at the level of the establishment, even over a short period of time. Second, due to the fact that the WES asks employers about their business strategies, Luchak and Fang are also in a position to link pension and group RRSP coverage (and its absence) to the emphasis that firms place on particular business strategies.

Luchak and Fang note that, in 1999, there were just over 40,000 establishments that had only workplace pension plans in place. By 2001, this number had declined to just under 36,000, for a net loss of 10.84 percent. However, this net change reflects the substantial netting off of much larger gross flows. More than 8,000 establishments adopted new pension plans; there were almost 1,000 establishments in which group RRSPs were replaced by workplace pension plans; and in more than 3,200 establishments, the group RRSP component of a combined pension/group RRSP program was terminated. On the other side of the ledger, just over 8,000 establishments terminated workplace pension plans; about 2,000 substituted group RRSPs for pension plans; and more than 6,700 added a group RRSP to a pension-only situation.

The number of establishments with only group RRSPs grew by more than 20 percent, from 46,379 to 56,204. More than 16,000 establishments adopted new group RRSPs, while nearly 12,000 terminated these plans. The substitutions and moves to combinations are mirror images of the pension-plan-only data.

Given the large numbers involved in the gross flows, it should be remembered that these are observations at the establishment level. There will be many situations where a single firm-level decision to change will show up as a large number of changes at the establishment level. It is important to note that there is no qualitative aspect to the pension plan definition. Thus, there is no way to know whether a DB or a DC plan is being replaced by a group RRSP. It is also important to note that the two-year period captured in the Luchak and Fang data is a period in which the PPIC data suggest there was slow growth in workplace pension plans and a private sector move to DC schemes.

Luchak and Fang also employ the WES questions in the employer survey about business strategy to explore the relationship between pension and group RRSP coverage and business strategies. The WES asks employers if they compete based mainly on product quality and after sales service, innovation or cost reduction. There is a clear association between each of the three business strategies and coverage. When the business strategy emphasizes product quality, a workplace pension plan is more likely than otherwise; when innovation is given the accent, group RRSPs are more likely; and, when cost reduction gets the accent, no retirement benefit is more likely. These relationships hold at particular moments in time, and shifts in strategy are associated with changes in these directions at the margin.

Finally, it should be noted that Luchak and Fang confirm the importance of unionization and full-time and permanent work in explaining coverage.10
Recent pension plan financing issues

In the section of this study entitled “The regulatory and tax environment of workplace pension plans,” the basic rules governing the financing of workplace pension plans were explained. In this section, attention focuses on how those rules have interacted with changes in the financial environment to create problems for DB pension plans since 2000. There is also a brief discussion of how governments have responded to changes in the financial situation of DB pension plans.

Financial changes in the early 2000s

The latter part of the twentieth century was a period when DB pension plans could operate with little worry about their financial situation. The stock market was booming in an unprecedented fashion despite very high yields on long-term bonds. Indeed, the high yields were generally well above the nominal discount rates used in going-concern valuations so that the new requirements for solvency valuations did not seem particularly onerous. An added financing bonus was that real wage growth was generally low.

After 1999, the situation changed rapidly. The stock market bubble burst in Canada as elsewhere in mid-2000. Real returns on the Toronto Stock Exchange, Canada’s largest, were minus 13.18 percent and minus 15.71 percent in 2001 and 2002 respectively [CIA 2005]. Overall, real returns on equities improved substantially starting in early 2003. However, the asset side of Canadian DB balance sheets was damaged in the early 2000s in a way that had not been experienced in the late twentieth century. Meanwhile, the liability side of the solvency balance sheets was negatively affected by declining yields on long-term bonds, which were falling below the going-concern assumptions. The decline in bond yields did not stop in 2003.

The net result of the changes in financial markets was that solvency balance sheets, which are tightly tied to changes in financial markets, swung quickly from surpluses to deficits in the early 2000s. The province of Ontario, which is Canada’s largest regulatory jurisdiction, reported recently that the percentage of all plans registered in Ontario that faced an actuarial deficiency on a solvency basis increased from 58.2 percent to 76.1 percent between 2001 and 2002. The percentage of underfunded DB plans increased to 83.1 percent in 2004, reflecting the continuing decline in yields on long-term bonds [FSCO 2006].

The percentage of plans that were less than 80 percent funded grew more rapidly than the total of underfunded plans. The percentage of plans that fell below the 80 percent funded benchmark more than doubled between 2001 and 2002, from 23.4 percent to 50.6 percent. Over the following two years, the percentage of plans in this situation fell to 38.2 percent. It is important to note that the FSCO data show that flat-benefit plans and career average earnings plans are more likely than other DB plans to be underfunded.

The underfunding of DB plans manifested itself most clearly in a dramatic increase in employer contributions. Over the period from 1993 to 2000, there had been a slight downward trend in annual employer contributions to DB plans, from $8.4 billion to $6.4 billion. However, by 2002 employer
contributions increased to $11.3 billion, and in 2004 they reached $18.5 billion [Statistics Canada 2006]. This dramatic increase in contributions is not explained by an increase in plan membership. It is attributable to the solvency rules in place and their interaction with the changing financial environment. Not surprisingly, employers and their professional service providers expressed a great deal of concern about both the ‘unpredictability’ of this large increase and, generally, about its size [Conference Board and Watson Wyatt 2005].

The other concern that arose from the deterioration in the funded status of DB plans was a concern for the security of plan members’ benefits. The federal pension regulator had a large number of the DB plans it regulated on a ‘watch’ list that indicated its concern for their financial viability [LePan 2004; Dickson 2005]. Moreover, there were two high profile cases of large firms (Air Canada and the e-STEEL Company of Canada) coming to the brink of bankruptcy with underfunded DB pension plans. In both cases, plan members faced the prospect of significant benefit cuts had the bankruptcies materialized. These case were also interesting because negotiations with both current creditors and prospective buyers became quite public, and the future pension arrangements at these companies became part of the negotiations. A smaller bankruptcy at Nakawic Paper in the province of New Brunswick did give rise to benefit cuts in a DB plan.

**Government responses to the DB funding issue**

Several jurisdictions, including the provinces of Quebec, Alberta and New Brunswick, have begun to offer relief to plan sponsors from the impact of increased special payments that have been triggered by solvency deficiencies. The federal government introduced temporary measures to address this issue in June 2006.

The federal measures apply to solvency deficiencies that arise in new actuarial valuation reports with effective dates between December 2005 and January 2008. Plan sponsors that are up to date in making their required contributions to their pension plans can extend the amortization period for their solvency deficiencies from five to 10 years in the following circumstances:

- two thirds of the active plan members and two thirds of the retirees have approved the extension of the amortization period; or
- the plan sponsor has received a letter of credit from a financial institution that covers the difference between payments made under the 10-year schedule and the payments that would have been made under the five-year schedule; or
- the plan sponsor is a crown corporation (i.e., a state owned enterprise).

Alternately, a plan can consolidate all outstanding solvency deficiencies and amortize the consolidated deficiency over five years. In cases where an amortization period is being extended with plan members’ consent, benefit improvements that would reduce the solvency status of the plan are not permitted.
These measures are noteworthy in several respects. First, the fact that they are temporary is striking. It is an important point of debate whether the financial problems of the early 2000s are temporary and unexpected, or whether, as Bodie [2006] has argued, they are predictable and preventable. This point will be returned to below.

The federal measures are also noteworthy in that, directly and indirectly, they begin to take account of the credit worthiness of the plan sponsor in establishing funding requirements. The preference given to crown corporations reflects an assumption of their superior credit worthiness. Moreover, the potential issuers of letters of credit are sure to take credit worthiness into account when they decide whether to issue the letters as well as in considering their terms and conditions. Generally speaking, Canadian regulatory regimes have heretofore relied exclusively on the status of pension balance sheets to determine the risk that plan members face with respect to the security of their benefits.

Finally, it is important to note the role of plan members’ consent in these measures. The scope for substituting plan members’ consent for prescriptive law has not been very fully explored in Canada.

Some additional comments on financing

Recent Canadian discussions of pension financing issues have focused almost exclusively on DB plans. However, the financial circumstances that have caused problems for DB plans (falling stock prices and declining yields on long bonds) have significant effects on DC plans as well. On the one hand, they will contribute to lower DC asset accumulations. On the other hand, and just as importantly, declining long-term bond yields will raise the price of annuities.

The problems described with respect to Canadian pension plans are common to pre-funded pension plans elsewhere. A general account of the financial problems of DB plans is provided in Schich [2005].

The regulatory authority in the province of Quebec, the Régie des rentes du Québec, produced a paper on the funding of DB plans that documents some important points that are widely understood but not well documented. First, the paper demonstrated a strong positive relationship in the late 1990s between the existence of surpluses in DB plans on the one hand and plan improvements on the other. This relationship throws important light on the question of how risks and rewards are shared in DB plans. The Régie also noted that contribution holidays were common in the 1990s (i.e., some portion of surpluses was used to reduce future contributions). The Régie also noted with concern that of 414 plans that took contribution holidays in 2002 and 2003, 135 had solvency ratios of less than 1.00 in their most recent solvency valuation and 24 had solvency ratios of less than 0.80 [RRQ 2005].
Some informed stakeholder concerns

The declining coverage of workplace pension plans, the shift from DB to DC schemes and the financial difficulties of DB pension plans have attracted a good deal of attention in recent years. A summary of all views would give rise to a massive volume. Without passing judgment on them, three will be noted here because the sources are significant to the future of workplace pension plans.

Association of Canadian Pension Management: Back from the Brink: Securing the Future of Defined Benefit Pension Plans

The Association of Canadian Pension Management (ACPM) brings together representatives of employers and other plan sponsors in both the public and private sectors, professional service providers (actuaries, fund managers, lawyers and others) and, to a lesser degree, other stakeholders, including plan members. In August 2005, the ACPM published a document titled Back from the Brink: Securing the Future of Defined Benefit Pension Plans. As the title suggests, its central preoccupation is how to restore growth to DB plans. In this regard, the document is overwhelmingly preoccupied with the issue of asymmetric risk in DB plans.

Asymmetric risk is seen to reside in the fact that plan sponsors are required to fund actuarial deficits but have limited access to surpluses. This is seen to create a negative environment for the initiation of DB plans, and it establishes a rationale for minimum funding of DB plans. Although concerns about asymmetric risk have been raised outside of Canada as well, the concern of the ACPM focuses on some specific Canadian court cases in which the question of the ownership of DB pension surpluses has been at issue. In a number of these cases, Canadian courts, including the Supreme Court of Canada, have invoked trust law in ruling that DB surpluses do not belong to plan sponsors. The ACPM argues that laws should exempt workplace pension plans from a ‘narrow construction’ of trust law and treat them on more of a contract law basis.

The ACPM calls for a broadly based discussion of pension financing rules and suggests a number of possible changes to those rules. Many of the suggestions are raised as much for discussion as definitive statements of preference. Moreover, they are commonly subjected to the caveat that their effectiveness will be limited unless the issue of asymmetric risk is addressed.

The suggestions cover a wide range of possibilities. A few stand out: regulatory law should focus exclusively on solvency requirements as opposed to going-concern requirements; a link between funding targets and portfolio risk should be considered; plans should be required to have a funding policy; amortization periods should be lengthened; the income tax limit on surplus accumulation in DB plans should be eliminated; and sponsors should be able to address solvency deficiencies with letters of credit.
The ACPM also sees the need for some clarification of the roles of legislators, plan administrators, plan sponsors and plan actuaries. In particular, the ACPM argues that it is the role of legislators, not actuaries, to set funding requirements and that actuaries should be dealt with as advisors to plan sponsors.

The ACPM suggests that, on plan windup, a sponsor should be obliged to amortize unfunded liabilities, which is not presently the case in the federal jurisdiction. However, it voices concerns about extending pension insurance beyond the province of Ontario; increasing the status of pension liabilities in bankruptcy; and recognizing the financial status of plan sponsors in financing rules.

**Keith Ambachtsheer: Cleaning Up the Pensions Mess: Why it will take more than money**

Ambachtsheer is a prominent pension consultant whose work has focused predominantly, but not exclusively, on investment issues. In a paper prepared for the C.D. Howe Institute in 2004, Ambachtsheer notes the financial concerns that were prominent at the time and argues that they are ultimately the product of poor governance and management of workplace pension plans, especially single-employer plans in the private sector.

Ambachtsheer notes that the risks in operating both DB and DC plans are seldom spelled out clearly and that is also the case with how the risks are allocated to different parties. He notes that common actuarial practice incorporates equity risk premia into the discount rates used to establish plan liabilities and contributions, but it is seldom the case that the risk and its consequences are clearly identified. Investment managers seldom have an integrated view of the asset/liability sides of the pension balance sheet and tend to be preoccupied with performance in relation to benchmarks rather than asset allocation. Responsibility inside firms for pensions is often fragmented.

Ambachtsheer sees the need for substantial improvement in clarifying roles, responsibilities and risks. He strongly thinks that the governance side of these objectives is best achieved when there is an integrated pension management organization and when risk-sharing with plan members is an explicit part of the pension arrangement. On the clarification of risk, he wants much more attention focused on measuring asset/liability mismatches.

**Kenneth V. Georgetti: Workplace Pensions: Current difficulties and going forward**

Ken Georgetti is President of the Canadian Labour Congress (CLC), Canada’s central trade union organization which includes roughly three million of Canada’s four million union members. As indicated in the discussions of pension coverage earlier in this study, Canada’s trade unions have been actively negotiating pension benefits since the end of the Second World War. The CLC has been addressing public policy issues related to pensions since its founding in 1956.
Like the ACPM, Georgetti is concerned about the future of DB pension plans. He notes that unions have a general preference for DB over DC plans as their benefits are more predictable. DB plans also permit past-service benefit improvements which allow plan members to make up lost time in retirement savings, and it is easier to structure DB plans to facilitate early retirement.

Declining pension plan coverage and the shift to DC plans are worrisome to Georgetti. He notes, however, that these trends are common in a number of countries and, while expressing the view that more work is required to understand what underlies these trends, he speculates that it is not uniquely Canadian forces such as court decisions. Georgetti expresses great scepticism about the theory of asymmetric risk and its explanatory power. He does note, though, that following the regulatory and tax changes of the late 1980s and 1990s, it became more difficult to negotiate new DB plans. He also notes that sectoral shifts in employment and the growth of precarious work have had a negative impact on pension coverage.

Georgetti expresses the hope that there will be more open dialogue among stakeholders and governments on pension issues. He raises the question whether the balance in Canada’s pension arrangements does not place too much emphasis on privately administered arrangements. He wants to find ways to reduce the volatility of pension contributions without compromising the security of plan members’ benefits. Georgetti suggests lifting the limit on DB surpluses under the *Income Tax Act*, creating pension insurance in all Canadian jurisdictions, and making pension contributions and deficits preferred creditors in bankruptcy. He also wants to promote the involvement of plan members in plan governance.

**Determinants of the evolution of workplace pension plans in Canada**

Previous sections of this study have described various aspects of the evolution of workplace pension plans in Canada. In the course of so doing, observations have been made about key influences that have shaped that evolution. In this section, those observations on influences and determinants are brought into shaper focus, and some new observations will be added. These will be addressed under the following headings:

- labour market influences
- financial market influences
- regulatory and tax changes
- governance and social partnerships.

**Labour market influences**

Earlier in this report, it was noted that employers are not required by law to establish workplace pension plans. Such plans come into being as part of employee compensation because employers want to use them to attract and retain employees, and because employees value pension plans. Moreover, it has been
noted that less than half of the employed labour force participates in these plans, and that the participants are not randomly distributed through the workforce. There are important variations in coverage based on sector of employment, unionization, size of employer, class of employee, security of employment or the lack of it, level of earnings and other factors. Supply and demand for particular types of employees are important. The important role of firm size suggests that there are significant economies of scale in delivering this particular form of employee benefit.

In recent years, the overall availability of pension plans has declined somewhat, and there has been a clear shift from DB to DC arrangements. These changes have been animated in significant part by changes in the labour market. Of particular importance in this regard is the ebbing of union membership and the increase in precarious employment, which has been coupled with a general shift in employment toward service sectors and trades that traditionally have had low pension plan coverage. (For an overview of these changes in the labour market, see Jackson [2005].) In addition, the Canadian economy has experienced substantial restructuring in recent years, and, as was suggested earlier in this study, some of the decline in pension coverage may have resulted from a change in which the bulk of Canadian firms are in their lifecycle. The particular supply and demand for specific types of labour in designated industries are important.

In addition, while it has not been mentioned specifically so far, overall conditions in labour markets are also likely to matter. In this regard, it is interesting to note that the end of growth in overall pension plan coverage as a percentage of the employed labour force coincided with a moment in time at the beginning of the 1980s when monetary policy became extremely contractionary in order to squeeze inflation out of the economy. While there have been ups and downs in the overall condition in the labour market since that time, there has been a general condition of slack in the labour markets, and increases in demand for labour have tended to elicit strong supply responses. As a result, average real wages did not grow over the 1980s and 1990s. This has not been an environment in which employers have faced strong general pressure in recruiting and attracting employees.

What might happen in the future is a matter of conjecture. If a general labour shortage emerges, as some predict, the ability of firms to attract and retain employees will become a greater issue. Moreover, it is a virtual certainty that the active workforce of the future will be older. One would expect the currency of DB plan to increase in that environment. In this regard, it is worth noting that, in a recent survey of employers, most thought that a pension plan that included a DB component was most helpful in meeting human resource objectives [Conference Board and Watson Wyatt 2004]. On the other hand, labour force participation in the age 55 to 64 age group has increased substantially in Canada in recent years, with many persons in this age range combining pension and employment income [Baldwin 2005].

**Financial market influences**

Experiences of the early part of the twenty-first century have put financial market influences on the evolution of workplace pension plans in sharp relief. They have focused attention on the volatility of required
contributions to DB plans and, in some cases, to issues related to the security of plan members’ benefits. They have also shaken confidence in DC plans and their ability to deliver reasonably predictable benefits.

Instability in financial markets has also added fuel to a very important ongoing debate about both the proper means of valuing pension liabilities (and to a lesser degree, assets) and what is a proper method of financing DB benefit obligations. There is a school of thought that says that the financial difficulties of DB pension plans were a predictable and preventable outcome of the deliberate mismatching of pension assets and liabilities [Bodie 2006]. This debate is important. However, what may be gained in terms of reducing volatility through asset-liability matching will likely require higher average contributions, and it is not clear how much willingness there is to pay this price.

The debate on asset-liability matching aside, it is likely there will be demographic feedback on pension plan financing in the future and that the various forms of feedback will tend to push required contributions upward. Some of the paths through which the feedback will come are:

- average attained ages of plan members will trend to be higher, thus shortening the average period over which pension plan contributions will be earning compound interest before benefits begin to be paid;
- the balance of plan liabilities between active and retired workers will shift toward the latter, thus increasing the need for liquidity in asset portfolios and, in practice – wider theoretical debates aside – pension plans typically match retired life liabilities more closely with bonds than stocks;
- growth in Gross Domestic Product, capital income growth and hence growth in stock prices may be slowed by labour supply contraction; and
- there will be an increase in persons wishing to liquidate pension assets compared to the number who wish to accumulate (purchase) them.

While these sources of demographic feedback will put upward pressure on required pension contributions, firms will be assessing their willingness to take on these increased contributions in a different labour market context.  

The role of DB plan surpluses in facilitating benefit improvements is likely to decline in the future.

**Regulatory and tax changes**

The major changes to regulatory and tax regimes in the late 1980s and the beginning of the 1990s were animated by quite clear objectives. The reformed regulatory regime was designed to correct what many saw as unfair treatment of plan members who terminated employment before retirement, part-time workers and so on, and generally to make workplace pension plans more qualitatively similar to the publicly administered programs. In the case of the tax rules, the changes were intended to equalize the tax room available for different types of retirement savings arrangements: DB pensions, DC pensions and RRSPs.
Initiatives in each area had both intended and unintended effects. The surviving population of DB plans was changed in key qualitative respects by the new regulatory laws. This is evident in areas like survivor benefits, benefits on termination of employment, eligibility requirements and early retirement benefits. However, it is likely more than a coincidence that the adoption of the new regulatory requirements and the new tax rules preceded the shift to DC schemes. Changes in both areas increased the administrative burden of operating a DB pension plan. In large plans these additional costs could be absorbed fairly easily, but that is less true in small plans. Executive plans aside, it is the small DB plans that have tended to disappear.

It is also worth noting that the discussion of the new tax rules focused on equalizing opportunities for tax-sheltered retirement savings by individuals in different types of institutional arrangements. The new tax rules accomplished this, although their implementation took much longer than initially planned. One side effect of the tax changes was to make the DC plans and group RRSPs more attractive from an employer perspective. For some, an additional advantage of group RRSPs is that they operate outside the regulatory framework that applies to workplace pension plans, including DC plans. That said, it is worth underlining the point that the new regulatory requirements that came into being in the late 1980s imposed greater burdens on DB plans than on DC plans.

It is difficult to anticipate future events in this area. It is recognized that the regulatory regime for workplace pension plans in Canada is quite prescriptive, yet there are important unresolved issues for both plan sponsors on the one hand and unions and plan members on the other. Moreover, conflict over pension surpluses has polarized parties to a degree that makes it dangerous territory for politicians to address. On a more hopeful note, both plan sponsors and members have faced some real dilemmas in the face of recent changes in the financial situation of DB plans. This has created a context in which some constructive dialogue has emerged among stakeholders.

Concern about differences among Canadian jurisdictions in the regulatory laws has been recognized quite widely. In some cases, these differences reflect genuine differences in policy. However, in other cases, the laws vary from jurisdiction to jurisdiction even where there is no real policy difference. While this problem is widely acknowledged, little positive action to correct the situation has been taken. If anything, the recent responses of governments to the financial problems of DB plans is indicative of them moving farther apart as each jurisdiction responds to particular constellations of political interests. The same could be said of initiatives taken by the province of Quebec that indicate new policy directions in regulatory law. Quebec requires the immediate vesting of pension benefits and also requires that workplace pension plans be administered by a committee that includes representation from active and retired plan members.¹²

One other development is worth noting if only because it may anticipate future events. In 2003, Canada’s pension regulators joined forces with securities and insurance regulators to issue best practices guidelines for what they called ‘capital accumulation plans’ (CAP). The term ‘capital accumulation plan’ refers to any savings plan that an employer administers for her or his employees, including a DC pension plan, a group RRSP, a deferred profit-sharing plan or whatever. This initiative was prompted by awareness on the part of the regulators of litigation over the operation of schemes of this sort in the United States, and concern on the part of securities’ regulators that the licensing and regulation which are common in the securities field do not apply to many CAP plans. While the CAP guidelines cover many issues, they focus attention particularly
on the appropriate range of choice that should be offered to plan members, and the counselling that should be available to them. This initiative suggests a new approach to regulating DC plans in the future that may reduce both their administrative simplicity and the limited financial liability with which they traditionally have been associated.

**Governance and social partnerships**

As was noted earlier in this study, there are several basic types of governance structure in Canadian workplace pension plans. In general, social partnerships have not been a significant element in pension plan governance in Canada. The major exceptions to this rule are provided by the target-benefit multi-employer pension plans and by the province of Quebec’s requirements with respect to plan administrator. That having been said, it is also true, as has been indicated previously, that the presence or absence of trade unions has been very important in the evolution of workplace pension plans in Canada. Union membership is strongly associated with pension benefits being present and with DB plans as opposed to DC plans.

In the recent past, pension plan governance issues have emerged in three areas. First, as suggested by Ambachtsheer [2004], there is a concern about the quality of plan governance. This issue arises in part out of a concern about the management of the schemes *per se*, and in part out of a concern about how large amounts of capital are being managed. Canada’s regulators have taken up this concern and issued *Pension Plan Governance Guidelines* in 2004 [CAPSA 2004]. This concern has focused a good deal of attention on the qualifications of those involved in plan governance and in their ongoing training and education.

There has also been an issue concerning conflicts of interest on the part of actuaries. This issue has been raised over the years by trade unions, which have argued that there is a conflict between the public interest roles that are assigned to actuaries under Canada’s regulatory laws and the actuaries’ role as advisor to plan sponsors. More recently, this issue has been taken up by the federal Office of the Superintendent of Financial Institutions, which is responsible for the administration of the federal regulatory law governing workplace pension plans [LePan 2004]. The issue has also been recognized by the Canadian Institute of Actuaries. None of Canada’s regulatory regimes requires the separation of the role of a plan actuary from that of an auditing actuary, as is required in some European jurisdictions. This issue is also reflected in the recommendation of the Association of Canadian Pension Management that actuaries be treated as advisors to sponsors.

The ACPM criticism of the application of trust law to workplace pension plans and the espoused need to distinguish more clearly the roles of sponsor and plan administrator are also indicative of real or possible role conflicts faced by employer plan sponsors. As Gillese [1996] points out, judicial interpretations of trust law allow some scope for an employer to act as an employer in administering a pension plan. However, at some imprecise point, that role gives way to fiduciary duty.

Finally, while caution should be used in interpreting the observation that follows, it is worth noting that there are recent instances in which a social partnership governance model has been adopted where,
traditionally, a governance model dominated by plan sponsors would have been used. The plans concerned tend to be found in the near-public sector and to involve joint governance by representatives of sponsors and plan member and joint sharing of special payments. The Ontario Teachers’ Pension Plan is the most prominent case in point. Whether the social partnership governance model will move beyond the near-public sector remains to be seen.

A social partnership governance model has been most often associated with a trade union pension agenda, as in Georgetti [2005]. However, it has also been espoused by Ambachtsheer [2004]. More surprisingly, a survey of chief financial officers conducted by the Conference Board of Canada and others found that 40 percent of the sponsors of overfunded plans and 14 percent of the sponsors of underfunded plans thought that plan members’ involvement in pension plan governance would make it easier to address problems faced by the plan [Conference Board and Watson Wyatt 2004]. Even though there are reasons to be concerned about the small size of the sample in this survey and what it represents, this result is surprising.

One could argue that the basic economics of workplace pension plans are a problem, and changing governance does not change the economics one iota. On the other hand, pension plans thrive on the confidence that plan sponsors and plan members have that the plans are capable of addressing their needs and are well and fairly run. Plan governance matters a great deal to these considerations. Moreover, a wider adoption of a social partnership model might permit some relaxation of the prescriptive quality of regulatory law.

**Acronyms**

ACPM Association of Canadian Pension Management
CAP Capital accumulation plans
CAPSA Canadian Association of Pension Supervisory Authorities
CIA Canadian Institute of Actuaries
CLC Canadian Labour Congress
C/QPP Canada/Quebec Pension Plan
DB Defined benefit
DC Defined contribution
FSCO Financial Services Commission of Ontario
GIS Guaranteed Income Supplement
IRC Industrial Relations Centre
LMAS Labour Market Activity Survey (Statistics Canada database)
LAD Longitudinal Administrative Databank (Statistics Canada database)
MEPP(s) Multi-employer pension plan(s)
OAS Old Age Security
OECD Organisation for Economic Cooperation and Development
PPIC Pension Plans in Canada (Statistics Canada database)
RRQ Régie des rentes du Québec
RRSP(s) Registered retirement savings plan(s)
SERP(s) Supplementary executive retirement plan(s)
Endnotes

1. These plans are sometimes referred to as occupational pension plans, employer-sponsored pension plans, private pension plans or, in Canada, registered pension plans.

2. It falls outside the scope of this study to discuss the issue at length, but it should be noted that the C/QPP reforms of the mid 1990s included a significant increase in the size of the reserve funds under these plans from a target level of two years’ plan expenditures to five years’ expenditures. While this still falls well short of ‘full funding,’ it is designed to permit the permanent stabilization of contribution rates below their pay-as-you-go level.

3. Generally speaking, in the private sector, everything is in principle subject to collective bargaining except for core management rights. Occasionally, when employers have established pension plans for all employees, they have claimed that the plans are non-negotiable, and they have also argued that unions cannot bargain on behalf of retired members. Neither argument has held up well in law or actual practice.

4. Jurisdiction commonly requires two consecutive years of earnings above 35 percent of the maximum level of pensionable earnings under the C/QPP (i.e., approximately $14,000 per annum). Some jurisdictions supplement this earnings requirement with an ‘hours of work’ requirement.

5. The description on financing rules is relevant to ‘self-financing’ DB plans. It does not apply to DB plans that buy insured products from insurance companies and pass on financial liabilities to them, as was quite common with small plans until the early 1980s. Nor does it apply to DC plans in which plan assets define liabilities, except in a minority of plans in which the plan establishes a fund to provide annuity payments. Some universities operate plans of this sort.

6. Pension insurance schemes operate in a number of other countries including the United States, United Kingdom, Germany, Japan, Austria and Sweden. An up-to-date overview of pension insurance schemes can be found in Stewart [2006].

7. Whenever the dollar sign ($) and the term ‘dollar(s)’ are used in this study, they refer to Canadian dollars (CAD).

8. Data from the PPIC are available on a compact disk [Statistics Canada 2006]. PPIC data from the period 1974 to 2004 that are cited without reference are from this source.

9. Through the 1980s and 1990s when DB pension surpluses were quite common, they were used in some high profile situations in both the public and private sectors to create temporary early retirement ‘windows’ (i.e., to offer early retirement benefits that could only be claimed within limited time frames). Typically, these were done when employers needed to go through substantial downsizing.

10. The strong relationship between unionization and pension plan coverage is also documented in Akyeampong [2002].

11. A rather strongly worded critique of his fellow members of the actuarial profession for not facing up to higher costs in the future is offered by Hurst [2006].
12. Over the period from roughly 2003 to 2005, CAPSA at the urging of the ACPM, in particular, conducted an extensive stakeholder consultation, the general intent of which was to make Canada’s regulatory laws for workplace pension plans as uniform as possible. This initiative was quietly abandoned.

13. Evidence of this concern on the international level is presented in OECD [2005].

References


