THE VALUE OF A GOOD PENSION

How to improve the efficiency of retirement savings in Canada

CONDENSED VERSION

HOOPP Healthcare of Ontario Pension Plan

NATIONAL INSTITUTE ON AGEING

COMMON WEALTH

THE VALUE OF A GOOD PENSION

While there has been vigorous debate about whether Canadians are saving enough for retirement, there has been much less discussion of <u>how</u> they are saving. Given stagnating income and strained household budgets, now is an important time to examine how best to achieve value for money in retirement savings. *The Value of a Good Pension* compares the efficiency of a variety of approaches to retirement, from a typical individual approach to a large-scale "Canada-model" pension plan (See Exhibit 1 below).

This research was led by Common Wealth in partnership with Healthcare of Ontario Pension Plan (HOOPP), with support from the National Institute on Aging. For more information on the methodology of the report please see page 45 of the full report. *The Value of a Good Pension* can be found at HOOPP.com/GoodPension. Please note, exhibits are pulled directly from the report and as such are not sequentially numbered for this document.

Exhibit 1

Five archetypes of retirement arrangement

The value for money in a retirement arrangement can be measured by the efficiency with which today's savings generate tomorrow's retirement income. In other words, how much does a person need to save, over a lifetime, to meet their retirement goals? This is influenced by saving behaviour, investment returns, and the ability to manage the post-retirement or "decumulation" phase in an efficient manner.

Good pensions create value for money for Canadians through five key value drivers.

A wide range of evidence indicates that individuals face significant challenges in saving for retirement, productively investing these savings and then converting these savings into a reliable stream of post-retirement income. Evidence also shows that good pensions can help overcome these challenges in significant, and quantifiable, ways. Below we divide these ways into the five key value drivers: saving, fees and costs, investment discipline, fiduciary governance, and risk pooling. We then synthesize the evidence drawn from academic and industry research to quantify them.

Exhibit 2

Five value drivers in retirement arrangements

	Description
Saving	In a purely voluntary system (a do-it-yourself approach), people tend to save less, save later, and save less consistently than under a collective plan with mandatory contributions or automatic enrolment.
Fees and costs	The costs of investment management and administration for good pension plans tend to be significantly lower than the costs of retail investing and advice.
Investment discipline	When investment decisions (e.g., asset allocation, security selection, market timing) are made by professionals, they tend to produce better results than when these decisions are made by individuals who "have a striking ability to do the wrong thing". [41]
Fiduciary governance	When investments are managed on a non-profit basis by in-house professionals with a fiduciary responsibility to members, they tend to perform better than retail funds offered by for-profit organizations.
Risk pooling	Most individual investors must manage their longevity and investment risk on their own, adopting costly strategies (e.g., larger nest egg, smaller draw down, highly conservative post-retirement asset allocation) to avoid outliving their money. By contrast, a good collective retirement plan can create efficiencies by pooling longevity and investment risk.

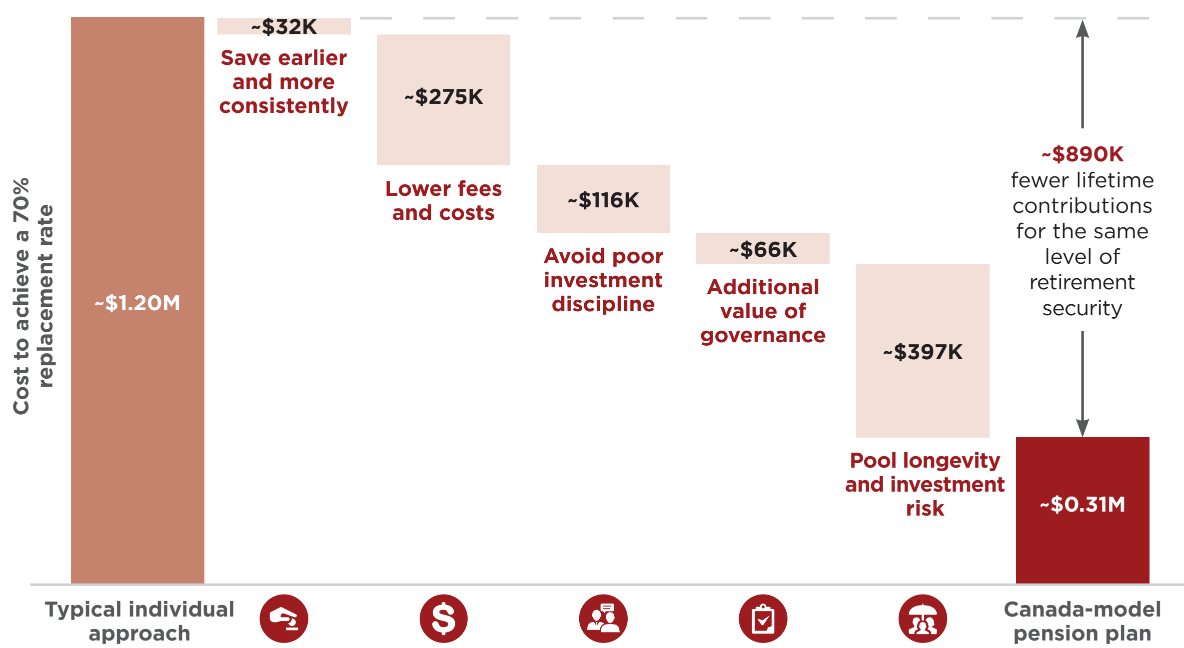
(see page 13 of the report)

For the same level of retirement security, the cost disparity between a Canada-model pension plan versus an individual approach amounts to a difference of about $890,000 over a lifetime.

The lifetime financial effect of combining these five value drivers is dramatic. By participating in a top-performing pension plan—a plan with Canada-model characteristics—a representative worker could achieve the same level of retirement income for a lifetime cost of nearly four times less than if they took a typical individual approach. This amounts to a lifetime savings of roughly $890,000.

Exhibit 10

A visual representation of the cumulative effects of the value drivers of a Canada-model pension for a representative worker



(see page 13 of the report)

For each dollar contributed, the retirement income from a Canada-model pension is $5.32 versus $1.70 from a typical individual approach.

From a retirement "bang-for-buck" perspective, for each dollar contributed, the retirement income from a Canada-model pension is $5.32 versus $1.70 from a typical individual approach (see page 50 in the report).

Although these numbers may seem high, they were calculated on a conservative basis and are consistent with findings from a recent study by Wilson Sy "Measured Investment Inefficiency of the Australian Superannuation System". This efficiency advantage applies regardless of where the contribution comes from, whether from the member, their employer or the government.

Pensions are too often associated with cost. This research shows that a better way to characterize pensions, especially if they are well governed and managed, is as efficient vehicles to pay for something expensive: retirement.

Exhibit 9

Retirement security for a typical worker is 4x less expensive in a Canada-model pension plan

Results for one representative individual

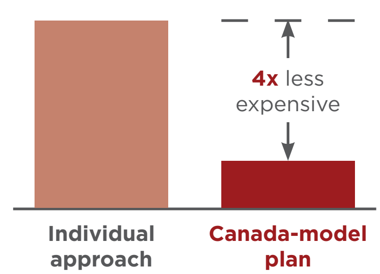
Sophia

Working life	• Works from age 25–65 • Lives to age 92
Earnings	• Earnings start at $40,000 per year • 3% annual earnings growth
Target replacement rate	• 70% of final 5 years' pre-tax earnings (including average CPP and maximum OAS)

	Typical individual approach	Canada-model pension plan
How much will I have to contribute to maintain my standard of living in retirement?	**$1.20M** Total contributions	**$0.31M*** Total contributions
What is my retirement "bang for buck"?	**$1.70** in retirement income per dollar contributed	**$5.32** in retirement income per dollar contributed

Relative value for money

Lifetime contributions required to achieve 70% replacement rate



*Total contributions include employer contributions

Policymakers should continue to support Canada-model pensions and encourage existing workplace retirement plan providers to adopt more of the features of a good pension for their plans.

In an era of government fiscal restraint and tight household budgets, it is especially critical that policymakers continue to support existing high-quality pension plans, of which Canada has some of the best regarded and most efficient in the world.

To take the opposite tack and move towards more individualized approaches to retirement would be to compromise value for money and efficiency. This would ultimately cost Canadians as savers, retirees, and taxpayers, and it would undermine a critical social and economic asset.

Policymakers should also encourage existing workplace retirement plan providers to adopt more of the features of a good pension for their plans discussed above.

Economic and labour market trends, including automation, the rise of “non-standard” work, and decreasing company longevity, suggest that, barring some intervention, the shift from collective to individualized retirement saving is likely to continue, if not accelerate. This is unfortunate, and would make retirement less efficient, and thereby costlier for individuals, employers and government.

About the Healthcare of Ontario Pension Plan

Created in 1960, HOOPP is a multi-employer defined benefit plan for Ontario’s hospital and communitybased healthcare sector. HOOPP has more than 550 participating employers and 339,000 members. Our mission is to provide healthcare workers with a financially secure retirement. We not only administer the plan but we also invest member and employer contributions into the HOOPP Fund to ensure that pensions can be paid now and into the future. That is our pension promise.

You can find the full *Value of a Good Pension* report here: Hoopp.com/GoodPension