

# RETIREMENT INCOME CRISIS: INEVITABLE OR AVOIDABLE?

THE ECONOMIC REALITY



**HOOPP**  
Healthcare of Ontario  
Pension Plan

## A MESSAGE FROM HOOPP PRESIDENT & CEO, JIM KEOHANE

March 17, 2014

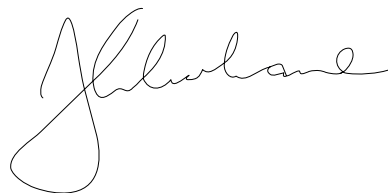
The following White Paper, entitled *Retirement Income Crisis: Inevitable or Avoidable? The Economic Reality*, summarizes the key points of two substantive research projects recently undertaken by The Boston Consulting Group and The Gandalf Group on the positive economic impact of defined benefit (DB) plans in Canada and Ontarians' concerns regarding their ability to retire with adequate replacement income, respectively.

These two studies approach the economic reality of retirement from two different perspectives. According to The Boston Consulting Group's study, DB pension plans play a significant role in powering economies, supporting growth and creating confident consumers whose spending is vital to the health of our economies. Of equal note is the research conducted by The Gandalf Group which found that the majority of Ontarians (86%) agree there is an emerging retirement income crisis in Canada.

The findings are clear. In Ontario alone, approximately 1.3 million defined pensioners inject an estimated \$27 billion back into the economy, with this impact most keenly felt in smaller communities where there is greater reliance on the predictable and secure retirement income offered through the DB pension model.

With this research, we have an opportunity to better understand the economic realities for those with a defined pension, for those without and for Ontarians as a whole. I believe DB pension plans provide the most effective and efficient way to deliver retirement security—it's important that the pension reform debate focuses on the most serious issue, which is ensuring solutions are found that provide retirement income adequacy for all Ontarians.

I encourage you to visit [hoopp.com](http://hoopp.com) to read summaries of each of these studies and to continue the dialogue on finding solutions to the issue of retirement income adequacy for all.

A handwritten signature in black ink, appearing to read "J. Keohane". The signature is fluid and cursive, with a large loop at the end of the last name.

## WHAT CANADIANS WANT FIXED — AND A SIX-POINT PLAN FOR GETTING THERE

Every Canadian should have access to a pension that guarantees a percentage of their working income in retirement— so says a majority of Ontarians (79%) as they become increasingly worried about a looming retirement crisis in Canada. With debt levels at all time highs and approximately 60% of the Canadian workforce not covered by workplace pension plans, research shows Ontarians are worried their savings won't be enough to keep them in retirement. They also believe government needs to step in and make critical decisions about how to solve the problem before a host of unfunded retirees begin to create a drag on the economy and on taxpayers. The question is, what needs to be done?

To help answer this, we look at two new pieces of research: *Defined Benefit Impact Assessment* by The Boston Consulting Group and the *2014 HOOPP Retirement Income Report* conducted by The Gandalf Group. Both provide unique insights on the benefits stable and adequate pension payments bring to the overall economy. Defined benefit (DB) plans not only create clear economic benefits across the country, Canadians would like everyone to have access to enhanced pensions that provide stable income and financial security in retirement. To that end, we also propose six best practices from Canada's DB pension plans that can be used to improve the system and make a workable solution for all Canadians.

### SECTION 1: DB PLANS AND THE CANADIAN ECONOMY

We know an estimated 60% of Canadians don't have access to a workplace pension plan. But whether it's a Pooled Registered Pension Plans (PRPPs), an expanded Canada Pension Plan (CPP) or a made-in-Ontario pension plan, policymakers and pension experts can't seem to agree on what kind of model will best broaden pension coverage. One thing is clear, however: the existing DB model brings substantial benefits to Canadians by giving them greater financial security in retirement and by reducing reliance on government benefits like the Guaranteed Income Supplement (GIS) to the tune of \$2 billion to \$3 billion annually.

The Boston Consulting Group notes that in 2012 DB plans collected between \$44 and \$47 billion in mandatory contributions from both members and employers—and they paid out between \$68 and \$72 billion in benefits.

Those benefits have flowed back into the economy. How? With 4.5 million active members and 3.5 million beneficiaries living across Canada, the benefits paid out by DB plans ultimately take many forms. This includes consumer spending and taxes, generating business growth, employment and revenues

for all levels of government. In Ontario, for example, DB pensioners contribute 7% of the total annual per capita income. Of particular note is smaller communities, where the impact of pensioner spending is felt the most keenly, double the provincial average in some communities.

### ONTARIO: PENSIONS MORE IMPORTANT FOR SMALLER TOWNS

2012 % of total earnings (% have been rounded)

Source: StatsCan, BCG Analysis



DB pensioners are closely tied to the economic wellbeing of communities both large and small—and their annual spending is impressive. They spend between \$56 billion and \$63 billion on durable and consumable goods spread across the economy and the country.

**Reduced dependence on GIS - DB plans give Canadians greater financial security in retirement and reduce reliance on government benefits like the Guaranteed Income Supplement (GIS) to the tune of \$2 billion to \$3 billion annually.**

## PENSIONERS BOOST ONTARIO'S ECONOMY

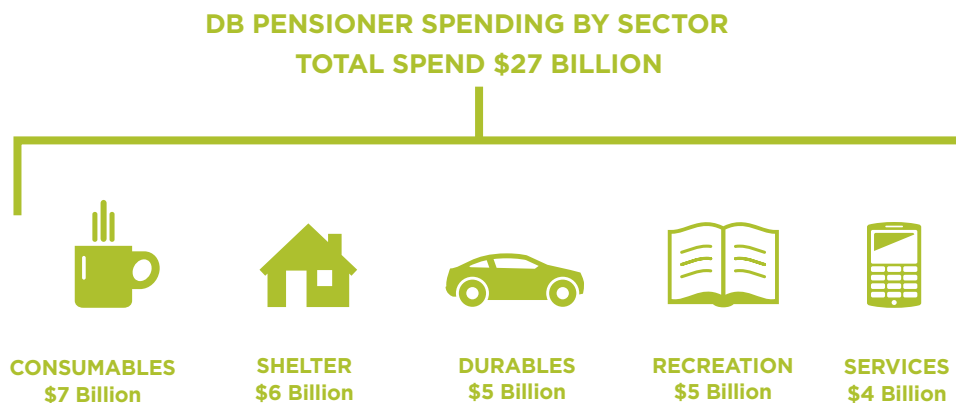
DB pensions are particularly important in Ontario, where plans pay out about \$27 billion to members, with most of those payouts coming from investment returns.

Those payouts generate an estimated \$3 billion in federal and provincial income tax, \$2 billion in federal and provincial sales tax and \$1 billion in property tax on an annual basis.

Able to rely on consistent monthly cashflow, Canadian seniors with DB benefits are confident consumers. In Ontario, they're spending approximately \$27 billion on consumables, shelter, durables, recreation and services.

## ONTARIO'S ECONOMY WITHOUT DB PLANS

What would the impact be on Ontario's economy if there were no DB pension plans? Below is a breakdown of what DB plan payouts contribute based on sector. What would happen if that money weren't there?



Clearly, DB pensions give Canadian seniors a better sense of financial security and that has clear economic benefits that flow to businesses, governments, and communities across Canada. They also reduce dependency on government assistance programs like the GIS.

But are they what Canadians want? Yes.

## SECTION 2: WHAT DO CANADIANS WANT?

While DB pensioners contribute to the overall economy and represent a healthy tax base for governments across Canada, what about the roughly 60% of the workforce without a workplace pension plan of any kind? Not only does a lack of pension coverage across Canada create economic risks—it's also keeping many Canadians up at night as they worry about whether they will have enough money to retire on.

Gauging how Ontarians feel about their retirement future is something The Gandalf Group has researched for the past two years. Its latest survey, the *2014 HOOPP Retirement Income Report*, finds that having enough money for retirement remains a top concern for Ontarians who believe strongly the country is headed towards a retirement income crisis. A majority—89%—of Ontarians express concern over the sustainability of the government's public pension system while 64% have concerns they won't have enough money to make ends meet in retirement.

The concern about adequate income in retirement is well founded. On average, the gap Ontarians see between expected needs and expected income is 11% of pre-retirement salaries—this means that the average Ontarian will receive 20% less income than is needed.

Not surprisingly, a clear majority of Ontarians (86%) say a retirement crisis is brewing in Canada and a further two thirds believe the burden will fall on taxpayers to support individuals without sufficient retirement income. This plays out clearly in the fact that 45% to 50% of Canadians without a DB plan that delivers adequate retirement income rely on GIS.

### CAUSES OF THE CRISIS

When it comes to causes of the crisis, most believe (and rightly so) that workers don't save enough money (75%).

But there appear to be some clear causes. In the situation we find ourselves in today, 69% say government doesn't do enough to force employers to provide good pensions to employees and 56% believe the government isn't doing enough to ensure employees that do have access to a plan join it. The bottom line: Ontarians believe that fixing a crisis involves mandatory participation not just on the part of employers but employees too.

While mandatory pension plans for employers and contributions by workers are one solution—what kind of retirement savings vehicle do people want? Ontarians overwhelmingly think DB-type pension programs in the workplace are the best way forward. A clear majority (79%) believe all workers should have a pension plan that guarantees a percentage of their working income in retirement in the same way a DB plan does. And 78% would prefer pension plans that pay out an amount based on earnings—not fluctuations in market returns. Again, this reflects the promise delivered by DB plans.

One important finding—many of those surveyed are even willing to take lower wages in return for a better pension plan (42%).

#### **WHAT'S THE SOLUTION?**

So how can this be fixed? Companies can and should offer pension plans that provide workers with adequate income in retirement—in fact, 59% say it's their responsibility.

Why? Because the economy could be adversely impacted by a retirement crisis. Indeed, the majority of Ontarians—65%—believe that without pensions that ensure adequate income at retirement the economy will suffer. And workers without adequate pension coverage will become a cost to taxpayers, as well as a drag on the economy.

## **78% of Ontarians support increasing CPP contributions and benefits by 60%.**

Does a solution involve dismantling existing DB plans? Not according to the majority of Ontarians (65%) who don't think it's unfair that some workers have better pension plans than others. Most do want the system fixed for everyone, though. A majority (57%) believe the government has not done enough to regulate corporate pension plans to ensure they are stable.

For 61% of Ontarians, the solution lies in modelling private sector benefit plans after public sector DB plans.

### SECTION 3: A SIX-POINT PLAN FOR PREVENTING A RETIREMENT CRISIS

Pensions and retirement income adequacy are two of the biggest issues facing Canada in the coming decades. But existing best practices can be used as tools for enhancing what is currently available to workers and for perhaps expanding coverage. While there are resources out there for improving what's currently on offer, it will take commitment from government to turn those ideas into concrete solutions that can help everyone.

Below are six best practices from the DB space that policymakers can look to for making progress in pension coverage right now:

**MAKE IT AUTOMATIC AND MANDATORY**—Workplace pension savings plans must be mandatory. Employers must offer them, employees must join and contributions must be made automatically (albeit at realistic levels).

**EMBRACE MODELS FOR BROADER PENSION COVERAGE**—Whether it's PRPPs or an expanded CPP, there are many excellent ideas for expanding coverage and delivering adequate pension benefits to all Canadians. Like anything, they have benefits and drawbacks. Doing nothing, however, is the worst option of all. Policymakers must act and choose a way forward.

**RISK SHARING**—Risk sharing is one of the biggest advantages to the DB model. Members of a DB plan can count on their retirement benefit and trust their contributions will lead to consistent and adequate retirement income. Pensions—defined contribution or otherwise—must find a way to ensure that pensioners do not bear 100% of market risk or 100% of longevity risk. Canadians who outlive their savings will evolve into burdens on the taxpayer.

**POOLING**—When individual savings are pooled in one large fund and invested by professionals, investment risk is both shared and reduced and costs are much lower than they would be for retail mutual funds.

**ADEQUATE INCOME REPLACEMENT**—Pension plans that do not set an income replacement target are simply not adequate for Canadians—they are merely savings accounts whereby the saver bears considerable risk that he or she will not have enough money to survive in retirement. What is the alternative? Income replacement based on a percentage of pre-retirement earnings—this must be part of any pension plan's design. DB plans do this. The result—confident, secure Canadians with access to predictable income in retirement and the ability to direct those dollars back into the economy.

**MAKE THE DRAWDOWN STAGE EASIER**—DB pensioners don't have to worry about what to do with their money once they retire. It stays with the plan, which keeps the money invested and pays out pensions throughout retirement. This one-stop option to retirement savings makes life easier for pensioners, rather than leaving it up to the individuals to decide how much to withdraw each year, and how to invest the remaining money so it lasts.



## CONCLUSION

A real solution to the retirement crisis is one that benefits all, not just a few. And while there is no shortage of good ideas that can help ensure Canadians are financially secure in retirement, it will take commitment from both governments and employers to create a long lasting fix. Without that, taxpayers will inevitably face the reality of rising costs as generations of retirees begin to drag on public benefits like the GIS, which is already one of the most expensive federal government programs on offer.

One thing is clear, however. The right solution can and should adopt the best ideas and concepts from the defined benefit model. Canadian savers should not be subject to the ups and downs of global markets. Instead, they should be guaranteed at least a portion of their working income when they retire. After all, they've earned it.

Disclaimer: Information in this document is sourced from a Study conducted by The Boston Consulting Group (BCG) and commissioned by Healthcare of Ontario Pension Plan (HOOPP), Ontario Municipal Employees Retirement System (OMERS), OPSEU Pension Trust (OPTrust) and Ontario Teachers' Pension Plan (OTPP). The materials excerpted by commissioners from the Study referenced are provided for discussion purposes only and may not be relied on as a stand-alone document. Additional analysis has been done to the data and analysis contained within the Study by third parties other than BCG. BCG has not independently verified this additional analysis and assumes no responsibility or liability for it.