

Pension Policy

**Creating a Fairer Pension System in Canada:
Ideas to Make Canada's Federal Government Employee
Pension System
Fair for Taxpayers and Employees**

By

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KEY POINTS

- The system of pensions that has been created for Canada's public sector was developed with the idealistic goal that retired public sector workers in Canada should have a disposable income close to their final salaries.
- However, a pension system based on final salary is no longer sustainable. Successive governments have failed to make the changes necessary to ensure that the system will succeed over the long term.
- With pension shortfalls in most public sector pensions plans, long term solvency is in doubt. Public sector employees might appear to have little incentive to push for reforms ye they will pay a price for inaction. Doing nothing to current pension obligations will cost public employees everything.
- The current system is providing employees with pensions for longer than many will have worked over the course of their lifetimes. As well, many retire with a higher disposable income in retirement than they had over the greater part of their working career.

Estimated savings on proposal \$ 3.144 Billion

Pensions were originally designed to protect workers from the possibility of living in poverty during retirement. Such protection is an admirable goal for society, and one that we support. The combination of the Old Age Security program, the Guaranteed Income Supplement and the Canada Pension Plan, in addition to RRSPs, provides this for many Canadians, and these programs should certainly be tweaked to better provide for those seniors who are still struggling financially. Public sector unions, however, have negotiated pensions that lift their retired members far above the poverty line. Their plans have been heavily funded by Canadian taxpayers and provide a seamless level of income support for public sector employees, spanning their careers and continuing into their retirement until death. In fact, many retirees on public sector plans have a higher disposable income in retirement than they had on average during their working years. It is unfair for taxpayers to be on the hook for these liabilities.

Public sector pensions have traditionally been defined benefit plans. This is consistent across Canada and throughout the Western world. In the past decade these pensions have started to create serious financial distress for many levels of government, Canada is no exception. There has been a serious lack of discussion in Canada about public sector pension reform, but other governments have begun to address the issue. The UK, California, and Rhode Island have finished in-depth analyses to uncover systemic problems in public sector pensions and identify the best options to correct pension-related problems going forward.

We applaud the measures the Minister of Finance, Jim Flaherty, has taken towards securing better retirement security for all Canadians. The implementation of the Pooled Registered Pension Plan (PRPP) is a very positive initiative. These plans have worked successfully in Australia, New Zealand and the UK is in the process of implementing this type of plan. The PRPP was determined as the preferred method of retirement security enhancement. It was chosen after several provinces went through pensions reviews, many had retirement security commissions and the federal government had at least two reports on the issue. What was disappointing is that after all this work no examination of public sector pensions, the 800 pound gorilla in the corner, was undertaken.

Reasonable Reforms

This brief will present ways to control the cost of public sector employee benefits and at the same time make them fair for federal employees.

1. Equitable pension contributions between taxpayers and employees

It is standard practice in the private sector for employers to match the retirement contributions of employees in Group RRSP savings plans. The federal government offers a very generous program whereby employees are only required to fund 32% of the cost of their retirement.¹ It is actually higher because the current contribution rates by both taxpayers and employees is less than is actuarially required to keep the plan fully funded.

The federal public sector pension plan is estimated by CD Howe to be underfunded by \$200 billion. In 201 total employee and taxpayers contributions into the federal employee pension plan were \$4.3 billion², an increase of 15.5% over the previous year. Based on the current contribution levels this means that employees contributed \$1.376 billion and taxpayers funded \$2.924 billion.

If the contributions rates for public sector employees and taxpayers were made equal based on the current contribution rates, which are still not enough to be sustainable long term, this would save taxpayers \$774 million based on last year's numbers. Assuming that the contributions increase is the same in 2011 as it was in 2010, the potential savings for 2011 would have been \$890 million.

Estimated Annual Savings from Equalizing Employee and Taxpayer Contributions: \$890 million.

2. Change the retirement age for the public sector

According to a 2008 StatsCan study, "Federal Public Service Retirements: Trends in the New Millennium,"³ Canada's public sector employees retire earlier than any other in the world. The study notes that while the average age of retirement within the Canadian labour force in general is close to 62, in the public sector, 58 has been the average age of retirement over the last decade.

A major recommendation of the Independent Public Service Pensions Commission⁴, known as the Hutton Report, from the UK was that there is no

¹ Treasury Board of Canada Secretariat, "The Public Service Pension Plan - Overview", 2010
<http://www.tbs-sct.gc.ca/hr-rh/bp-rasp/pensions/overview-apercu-eng.asp>

² Treasury Board of Canada Secretariat, "Report on the Public Service Pension Plan for the Fiscal Year Ended March 31, 2010", 2011
<http://www.tbs-sct.gc.ca/reports-rapports/pspp-rrfp/2010/rpspp-rrrfp01-eng.asp#c04>

³ Statscan, Dan Fox, "Federal Public Service Retirements: Trends in the New Millennium",
<http://www.statcan.gc.ca/pub/11-621-m/11-621-m2008068-eng.htm>

⁴ Independent Public Service Pensions Commission, [Independent Public Service Pensions Commission: Final Report](#), March 10, 2011

reason the public sector should have one retirement age and the general population another. Hutton concluded that the age at which the public sector is entitled to draw their pension be raised, as people are living longer. In Canada the CPP standard age for retirement is 65.

Hutton made special note that "Uniformed Services" - the armed forces, police and firefighters - should see their pension age rise to 60. In Canada our "Protection Services" are entitled for full pensions as early as age 50 and the rest of the public sector follows at age 55.

The Ontario Municipal Employees Retirement System⁵ estimates that early retirement cost about 16.14% of the total retirement pensions costs of a retired employee. The average new federal pension last year was \$35,000 and the average Canadian who reaches age 65, now lives another 19.8⁶ years, close to age 85.

A federal employee retiring with an average pensions at age 55 will collect close to \$1 million in lifetime pensions. The early retirement portion of this is estimated at \$161,000. **Considering there are 317,000⁷ federal employees the cost savings would be \$67.6 billion over the next 30 years.** The savings for this program would be split 50/50 between taxpayers and employees.

Estimated Annual Savings from Changing the Retirement Age for the Public Sector: \$858 Million

3. Convert pensions from final average salary to career average

Current public sector pensions boost payouts by allowing members to use their highest three or five years' income as the base for pension benefit calculations. Private sector DB pension plans use lifetime career average incomes. This change would make pensions more sustainable and reduce the risk of future shortfalls.

The Province of Saskatchewan moved away from defined benefit pension plan about 20 years ago. At that time the Saskatchewan Teachers Federation set up a plan for their members. Since they are solely responsible for the plan without any taxpayer back stops they have had to make moves to ensure the long term solvency of the plan. As a result of teachers the prudent move of moving from a final salary plan into a career average plan. They will convert their plan to a career average defined benefit plan effective 2015.

With a salary grid reaching up to \$75,210 our estimates show that the career average pension is about 15% lower than the final salary pension. Not a bad place to start for all federal public sector pension reform.

The final salary pension for a Saskatchewan teacher would be about **\$ 50,441** including

⁵ OMERS, "Report to members 2006" , <http://www.omers.com/pdf/RTM2006.pdf>

⁶ Statscan, *The Daily*, " Life expectancy at birth and at age 65 by sex, Canada", February 23, 2010

⁷ Statscan, "Public Sector employment", May 27, 2011



Now more than ever pensions have become a major issue for our society.
This crisis has been building for several years.

Fair Pensions for All is an attempt to stay on top of the current issues surrounding pensions.

bridge benefit for a fully qualified pension. The career average pension assuming 2% annual increases over 35 years would be **\$43,350**, including bridge. Both assume 2% per year accrual with a 2% annual salary increase over 35 years.

Note that once the retiree reaches age 65 in the Saskatchewan plan, the CPP kicks in and this reduces the costs to the pension plan by \$11,500 in 2011. So the example above will only cost the pension \$31,850 after age 65. With a life expectancy of 85 the teacher retiring at age 55 will earn \$1.75 million on the average pension compared to \$2.04 million on the final salary pension. Compared to a lifetime earning while working of \$1.9 million, indexed at 2% per year, including CPP. This will save \$290,000 over the 30 year life of the pension plan.

There are 317,088 active employees in the federal pension plan. The savings to move to a career average plan could be estimated to be \$290,000 over thirty years for each employee. On an annual basis this change will save \$3.06 billion per year. Half of this savings would be in the pocket of taxpayers and the other half in the pocket of employees.

**Estimated Annual Savings to Convert Pensions
from Final Average Salary to
Career Average: \$ 1.53 billion million per year**

Please note that our first recommendation is accurate as stated but the next two would require an actuarial investigation.

**Estimated Annual Savings from Both Measures:
\$3. 144 Billion**

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