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Without a plan

Our pension system is a mess, and fixing it won't be easy

by Chris Sorenson on Wednesday, November 11, 2009 2:40pm - [7 Comments](#)



Dale Seto is accustomed to toiling out of the spotlight. Most days, the aircraft mechanic crawls around inside the guts of an Airbus jetliner, grease on his hands. “We’re kind of the underdogs,” says Seto, 57, who has worked for Air Canada for the past two decades. “But in my opinion, we perform the most important function in the entire airline industry, and that’s making sure that the planes are safe and ready to fly.”

Hundreds of thousands of lives depend on the quality of work done by Seto and his colleagues, but he says the industry’s perennial woes means they haven’t had a pay raise in nearly a decade. That helps explain why he and 12,000 Air Canada employees represented by the International Association of Machinists and Aerospace Workers jealously guard their defined benefit pension plans, an increasingly rare species of retirement income in the private sector. More than just a perk, defined benefit plans—in which the employer guarantees retirees a certain level of benefits—are viewed by workers as a key element of overall compensation.

But Seto’s plan to retire in two years has been called into question. Last year’s market crash kicked the stuffing out of many corporate pension plans, including Air Canada’s. Combined with a long period of historically low interest rates, the crash has left many pensions seriously underfunded. And companies already grappling with

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The good news, if you can call it that, is that the companies who manage to weather the economic downturn will likely be able to make up for some of their pension shortfalls as the market returns and the value of the assets in their plans increases. "If there's a strong company attached to the pension plan, then it's probably not a crisis," says Forestell. "The plans will get funded over time and pensions will continue to get paid."

Finance Minister Jim Flaherty last week unveiled Ottawa's long-awaited response to the pension crisis a month ahead of schedule, an apparent effort to quiet the growing calls for action. The cornerstone of the plan is a proposed change to tax laws so provincially and federally regulated companies can run pension surpluses during bountiful years, providing a bigger financial cushion when times are lean. At present, companies are capped at running 10 per cent surpluses in an effort to limit the revenue Ottawa loses on tax-deferred pension contributions. Under Flaherty's plan, the cap would be raised to 25 per cent. Critics, however, are quick to point out that few, if any, companies are currently running pension surpluses, making the proposed changes meaningless in the near term. There was also some tinkering with federal pension rules, but they only apply to a tiny fraction of the country's private sector plans.

Despite the calls from Nortel employees, Ottawa stopped well short of suggesting legislative changes to protect pensioners in the event of a corporate bankruptcy. While Liberal Leader Michael Ignatieff has said employees deserve to be near the front of the line as an insolvent company's assets are being carved up, experts argue such a move could displace other creditors and, in turn, make it difficult for frail companies to raise badly needed financing, potentially forcing more bankruptcy proceedings. In short, pensioners may never be guaranteed a soft landing when their employer goes belly up.

"It's a very complex issue, with cross-border jurisdictions and emotions," says MP Ted Menzies, who is Flaherty's point man on the pension issue. He suggests the intention is simply to improve the existing system, which Mercer ranked fourth in the world in a recent study. "We don't want to throw out the baby with the bathwater," he says. "We've got a good system. The question is how we make it better."

Suffice it to say, the temporary fixes and promised reforms have so far done little to ease workers' anxieties. In Air Canada's case, the choices being offered to workers like Seto are downright scary: either let the company temporarily pull back its funding of the pension, or the airline dies. And he is one of the lucky ones. What about the estimated 60 per cent of Canadian workers who don't have a pension at all?

Some say drastic action is needed. While Canadian workers who have contributed to the CPP are guaranteed a minimum level of retirement income, the mandatory employee and employer program only aims to provide about 25 per cent of an average worker's wage, or about \$11,000 in 2009. The rest is supposed to be augmented

by registered retirement savings plans, or RRSPs, and private sector plans. Yet, nearly 11 million working Canadians have no access to private pension plans since most are provided only by large corporations. At the same time, many of us lack enough discipline to save sufficient money for our golden years, raising questions about whether the government should do more to fill in the gaps.

One possible solution has been brought forward by the head of the CPP's investment board, David Denison. He has proposed that the CPP model could either be expanded by adding a supplemental pension benefit that would require increased contributions in exchange for more retirement income, or used as a blueprint for new mandatory or "opt-out only" plans targeting workers with no company pensions. Others have suggested the creation of multi-employer plans that allow smaller businesses to pool their resources and share the risk associated with setting up and maintaining a plan.

Governments may also be able to take measures to slow the stampede of private companies away from defined-benefit pension programs, which are generally viewed as offering more retirement security for employees because they guarantee benefit levels, but are more risky for employers because they're on the hook if the plan doesn't perform well. Defined contribution plans, by contrast, pass the risks along to employees by having them select from a basket of funds chosen by the plan's sponsor, usually the employer. Defined contribution plans have been criticized for essentially leaving people's retirement security exposed to the ups and downs of the markets.

An oft-touted middle ground solution is hybrid pension models. That includes so-called "target benefit" plans, where employers and employees agree on certain benefit levels that appear easily achievable, but which can later be adjusted based on actual investment performance. If the fund performs badly, benefits may have to be lowered. If it does well, they can be increased. Unlike defined contribution programs, such plans allow assets to be pooled and managed professionally, which is similar to the way defined benefit plans are operated. The hitch is that target benefit plans are more complicated for employers to operate and existing plans couldn't be easily converted. Federal and provincial tax laws governing pensions would likely need to be changed in order to encourage widespread adoption.

A key challenge in realizing any reform will be overcoming the patchwork of provincial and federal rules that govern the pension industry. As head of the leading advocacy organization for pension reform, Perkins says he hopes Ottawa's proposed changes to federal pension rules will light a fire under the provinces, several of which have already conducted extensive studies on the issue, but have so far failed to introduce changes. The main problems facing the system, he says, continue to be a lack of private sector coverage and the adequacy of private sector plans in general, but "having said that, there's lots of ideas floating around out there."

In the absence of any meaningful reform, current and would-be pensioners will continue to find themselves on shifting ground when it comes to old age security. Seto, for one, isn't holding out much hope that his Air Canada pension will deliver what it promised. Like many employees at troubled companies, he blames his predicament on executives for making bad corporate decisions and mismanagement. But he also says he feels betrayed by a federal government that held him and his colleagues accountable for years in the heavily regulated airline industry. "What the government has done is drop the ball on the whole situation—they aren't making sure the pension plans are being taken care of."

People like Seto are hoping someone comes up with a solution, but it's becoming increasingly clear that if you have any hope of one day retiring comfortably, you'd better start saving soon.

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the economic downturn can't afford the millions it would take to make them whole. "You had this sort of super-perfect storm," says Scott Perkin, the president of the Association of Canadian Pension Management.

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It's not just the grey-haired among us who are affected. Increasingly, employers are abandoning traditional, gold-plated defined benefit plans and asking new hires to participate instead in defined-contribution models, which pass the investment risk on to employees. Meanwhile, many smaller firms don't provide their workers with pensions at all because of the costs, leaving a majority of Canadian private sector employees without coverage. Governments claim fixing the system is a priority as legions of baby boomers prepare to leave the workforce over the next few decades. As pressure to do something mounts, Ottawa hurriedly unveiled a series of measures earlier this month to beef up the seven per cent of private sector plans in Canada under federal control. A step in the right direction, to be sure, but a tentative one at best. Ontario, too, has promised to take action to better protect the plans it oversees, but has yet to reveal specifics.

The harsh reality is there is no easy answer to the pension crisis. Any solution, experts say, requires meaningful legislative changes and a rare level of co-operation between Ottawa and the provinces, which are scheduled to have a pension summit in Whitehorse next month. It may also require a fundamental change in people's attitudes toward retirement planning in general.

With their pensions in jeopardy and nowhere to turn, hundreds of employees of Nortel Networks descended on Parliament Hill last week in search of help. As Nortel is broken up and sold off in pieces under bankruptcy protection, there's a risk that some of its underfunded pension plans—with a combined shortfall of between \$2 billion and \$3 billion earlier this year—could be wound up. In theory, these pensions are protected by virtue of being held separately from the plan's sponsor, although underfunded plans typically stay that way once a company files for protection from its creditors. In Nortel's case, some 20,000 employees face as much as a 30 per cent cut to their benefits. A similar story is playing out with employees of paper giant AbitibiBowater and media conglomerate Canwest Global Communications, both of which are operating under bankruptcy protection and are facing serious pension shortfalls.

Temporary fixes have been offered by Ottawa and some provinces—companies are typically given five years to top up underfunded plans, although that has been extended in some cases to 10 years—but the measures are the equivalent of sticking a Band-Aid on a heart attack patient. The Nortel situation in particular has prompted Quebec to take matters into its own hands. The provincial government has offered to backstop some of the 3,750 Nortel employees in the province by having Quebec's pension plan, run separately from the mandatory Canada Pension Plan, take charge of the assets. The arrangement, described as a "special situation," would last a maximum of five years and is bound to ratchet up the pressure on Ottawa to take similar measures for employees elsewhere.

Just how widespread is the pension problem? The average private sector plan is only 72 per cent funded, according to consulting firm Mercer. That's up slightly from a low of 60 per cent back in March thanks mostly to the market's halting steps toward recovery. The levels are higher, but still underwater—88 per cent, according to the most recent numbers—in federally regulated plans, including those sponsored by Canadian National Railway, Bell Canada and Air Canada. In fact, the only group in the country that can breathe easy are those who are employed by governments, which offer mostly gold-plated defined benefit plans that aren't in danger of being abandoned.

Even when augmented with employees' other retirement savings (which also took a major hit from the market crash), it all translates into a significant decrease in income and could mean the difference between a retirement spent golfing and travelling, and one spent looking for ways to pay the bills. Only Ontario has a pension guarantee system, funded by corporate contributions, that promises to pay out retirees who have had their pensions cut, but only to a maximum of \$1,000 a month. But even that fund is facing a massive shortfall. "It has created a number of stresses, both on companies and individuals," says Paul Forestell, who heads Mercer Canada's retirement, risk and finance business.