The Pension Problem

Are defined benefit pension plans safe?

By Peter J. Merrick

SEVERAL YEARS AGO I presented at an outplacement workshop where the majority of attendees were former Nortel employees. One man had brought with him an article from the *Ottawa Citizen*. It reported that Nortel's defined benefit pension plan (DBPP) was underfunded by $2 billion. Up until that moment, I had never considered that employer-sponsored DBPPs may not be able to meet their pension obligations. Once I started thinking about it, I couldn't stop.

Consider this, as the baby boomers start to retire en masse, beginning in 2010, Canada could see combined pension and health-care costs exceeding 25% of our total gross domestic product. In recent years, Canadian companies and their employees have seen their pension assets plummet from $614 billion at the end of 2000 to $541.6 billion in mid-2003. According to Statistics Canada, two-thirds of pension plans in Canada are now in the red.

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How did this happen? Changes in both the economy and in life expectancy. In the fertile stock market of the '90s, pension funds grew like weeds until many plans became overfunded. As a result, many companies did not have to make contributions and they could afford generous benefit increases to retirees. But when the stock market wilted in 2000, the investments in these plans failed to generate enough income to meet projected future obligations, and many DBPPs became underfunded. When this happens, companies are expected to make additional contributions, but not all companies have the money. To date, the largest underfunded pension plans in Canada are at Air Canada, Nortel, Alcan, CIBC and Bombardier. The largest underfunded private pension plan in the world is General Motors, with an estimated pension deficit of over $100 billion.

In the old economy, the average employee would work for the same company for 35 years. In their pension calculations, actuaries of DBPPs would make the assumptions that male and female workers would retire at 65, and the majority would die by 68 and 72. Now actuaries of these same plans need to factor in that today a minimum of 10% of all DBPP male pensioners will live beyond 91, and female pensioners beyond 94.

What if there's not enough pension money to go around? If a DBPP cannot meet its obligations, retirees will get first claim on the assets of the plan. Next will be employees who are eligible for pensions. The remaining money is then divided among the rest. Ontario is the only province that has created a Pension Benefits Guarantee Fund (PBGF), which offers limited protection for the over one million DBPP members within its borders. If a DBPP in Ontario has insufficient funds, the PBGF will guarantee only the first $1,000 per month of pension benefits.

There are other employer-sponsored savings plan options. Over the last decade, employers have moved away from traditional DBPPs, where they have guaranteed the benefit payout of these plans, towards group RRSPs, defined contribution pension plans (DCPPs), deferred profit-sharing plans (DPSPs) and employee profit-sharing plans (EPSPs), thinking they have less liability because employees control investment decisions in these plans. However, these employers should be aware that the Canadian Council of Insurance Regulators, the Canadian Association of Pension Supervisory Authorities and the Canadian Securities Administrators have created what is known as the Joint Forum of Financial Market Regulators, which has come out with a report on capital accumulation plans, strongly recommending that employers' responsibilities for these plans be expanded to include providing access to investment decision-making tools and cautioning employees that they ought to obtain independent investment advice. The Joint Forum has also stated that companies providing their employees access to capital accumulation plans may be held responsible for investment losses that their employees incur in their company-sponsored retirement investment plans.

With all the changes coming down, employers should carefully rethink their employee benefit plans. Some innovative employers have found that making financial planning a core employee benefit is their best solution to mitigate their risk while meeting their objectives of improving employee satisfaction, reducing turnover and increasing productivity.

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