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NAVIGATION BUTTONS

An interview with Laurence E. Coward

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Laurence Coward on the slopes at age 79.

Laurence E. Coward is a Director Emeritus with William M. Mercer Limited, an employee benefits consulting firm, in Toronto. Born in London, England in 1914, he came to Canada in 1949 to join the company as its first actuary. As Vice-President since 1955, he has had an illustrious career serving businesses, governments and Royal commissions as a pensions and benefits consultant. His professional offices have included being the first Chairperson of the Ontario Pension Commission, President of the Canadian Institute of Actuaries, and President of the Canadian Pension Conference. Mr. Coward is the author of many articles in actuarial and business publications, and his ***Mercer handbook of Canadian pension and welfare plans****, now in its 10th edition, is regarded by many as the most comprehensive study on Canada's pensions and employee benefits system.*

Q. *Canada's pension system is a combination of public plans and private arrangements that have evolved over time. What are some of the most important changes you have seen implemented in the last 30 years?*

A. About 30 years ago, the federal government wanted to bring in a national contributory wage-related pension plan. But it took a few years to get this organized, over opposition from some of the provinces, and the Canada Pension Plan came into effect on the 1st of January, 1966. [1] Also, the Old Age Security, which had been set at $40.00 a month at age 70, became $75.00 a month, payable at 65. At the same time, we got the Guaranteed Income Supplement, or GIS. Since then, there has been continued liberalization of such Acts; for example, Canada Pension Plan benefits can currently be taken at age 60 and the OAS benefit has gone up to $385 a month. The other big change was the introduction of the Pension Benefits Act of Ontario in January 1965, soon followed by similar Acts in other provinces.

VIEW ▶ Diagram **Canada's retirement income system**

More recently, there's been a clawback of Old Age Security through the tax system. [2] Even so, the security for old people now is vastly greater than it was before. They no longer have to depend on their children to support them in their old age; Canadians now rely on the government or their employer.

Q. *Wasn't the GIS intended to be a temporary measure?*

A. It was brought in as a transitional measure, until the Canada Pension Plan matured. But when CPP benefits showed signs of levelling off, the government found another use for it. It became a general supplement, to maintain a minimum income for everyone, which it's done quite effectively. The Old Age Security plus GIS provides more than $10,000 a year for a single person. In Ontario, there's a provincial supplement of about $1,000. Other provinces have other supplements. So a single person over 65 who has resided for a certain number of years in Ontario can get about $11,000 a year. And a married couple can't get less than $18,000 a year, even if they have no other income, including no Canada Pension Plan benefits.

That's a fairly high basic level in regard to minimum wages. Especially if you recollect that a great many goods and services are available to seniors at substantially lower prices. Income tax is reduced, and seniors no longer have to contribute to the Canada Pension Plan or pay union dues. Public transportation is available at a lower rate; movies are half price. Until recently, I was able to ski for nothing at many of the best resorts. Now they're all charging something, but it's still at a reduced price. Our minimum standard for pensioners is a vast improvement over what it was a few years ago.

Q. *Despite legislated annual increases in contribution rates, the CPP is regarded by many as having an* *uncertain future. The federal Deputy Minister of Finance has warned that the program will have to be changed for it to remain sustainable without exacting unwieldy contribution requirements. What advice would you give to working Canadians who may face curtailed C/QPP benefits in the future?*

A. The latest Canada Pension Plan report does not alarm me particularly. The pay-as-you-go rates projected to 2025 are only marginally higher than they were in the 1988 report - about 0.2% higher, reaching 12.4% that year. As for the working Canadian's reaction to that, I'm reminded of what my old aunt used to say, "What can't be cured, must be endured." Obviously workers should, as far as they can, contribute more to registered retirement savings plans and to a registered pension plans. They can postpone their retirement a few years longer - if they can manage to retain their job. We're going to have to tolerate some modification of the Canada Pension Plan to reduce its costs a bit. I think there will be great pressure to raise the age of commencement of benefits, after a transition period. The United States has already done it, and it is perhaps the most painless way of reducing costs.

In *The Prince*, Machiavelli said that the public could stand any burden or hardship so long as it was imposed gradually. We are subject to high rates of taxation and contributions for benefits, far beyond what would possibly have been acceptable 30 years ago. The price of our security may go higher still. But since it comes in slowly, we grin and bear it.

Q. *Can you expand on the possibility of postponing the eligibility for full CPP pension past 65?*

A. That's very likely going to happen. In the United States, the earliest age at which one can take benefits is 62. We have an early benefit at 60 and a full benefit at 65. It doesn't seem unreasonable for 62 to be the minimum age and 67 the normal age for the full standard pension. Of course, the change would have to be brought in gradually. In the United States, retirement at 67 is slated for the year 2027.

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Q. *The CPP combined employer/employee contribution rate is currently legislated to reach 10.1% by 2016, more than twice today's rate and nearly three times the rate in place before 1987. How do you think employers may respond to these increasing premiums?*

A. Employers will obviously try to pass on the cost to employees if they can. They've got to keep total compensation down to remain competitive. So, if they have to pay more for pensions, they're going to try and find some other benefit that can be reduced, or there'll be pressure for smaller negotiated pay increases. They may even employ fewer workers. I don't know if employers will cancel their registered pension plans because of the extra costs. I think probably not, although there will be a greater tendency to go to money purchase plans or group RRSPs because this makes the costs definite. [(3)]

Q. *What can you tell us about the development of employer-sponsored pension plans?*

A. The old idea was for pensions to be granted to people who were physically unable to work. For example, many years ago, I met the president of a large company who said, "We don't have a pension problem here. We offer work for every able-bodied man who is ready to work. If he's been with us for some time and then can't do the job, the directors award him a pension, which might be $50.00 a month. Besides, our pensioners don't live very long, only four years on average."

It wasn't until unions began to negotiate pensions that employers began to formalize their pension arrangements. A U.S. court case in 1952 established a union's right to negotiate for pensioners. Previously, employers had argued that pensioners were no longer union members, so unions had nothing to do with the issue. But the unions claimed to be negotiating future benefits for present members. The employers gave in and then, a little later, agreed to increases for pensioners even though they were no longer union members. And from 1965 onwards, more and more regulatory legislation required employers to formalize their pension plans. Since then, all provincial governments have passed pension legislation.

It would be wonderful if there were uniformity and less complexity in pension legislation across the country. I was on the Ontario Pension Commission for about 15 years. We always believed in keeping things reasonably simple. The objectives were to ensure reasonable benefits for terminating employees and a reasonable solvency of the plan. Without fussing a lot over minute details, we concentrated on those things, and I think the Act worked very well for a long time.

There will be great pressure to raise the age of commencement of [CPP] benefits, after a transition period.

Q. *In recent years, participation in employer-sponsored pension plans has not kept pace with labour force growth. At present, only about 45% of employed paid workers are covered, down from 49% ten years ago. Why is this happening and do you see declining coverage rates as a serious concern?*

A. Workers are more mobile. Every time they change their job there's a waiting period before getting into a plan. We're also seeing an increase in part-time and casual workers, especially women. Part-time workers who don't work a minimum number of annual hours may be excluded from the pension plan. Another reason is that employers have become a little less paternalistic; to some degree, they are responding to the employees who are demanding more flexibility because of varying family situations.

Also, there has been a move from pension plans to group registered retirement savings plans. The CLHIA report said that in 1992 they had 657,000 group RRSP members. (4) That's an appreciable number, because I don't think there were any group RRSP plans 10 years ago. It would be very interesting if Statistics Canada found out how many people are in these plans, and how much money is going in.

Q. *Are today's employer-sponsored pension plans generally solvent? Is there a need for such safeguards as the Ontario Guarantee Fund?*

A. It depends on what you mean by solvency. A well-known actuary once said that a plan is solvent if you know what your requirements are going to be and you know where the money is coming from when you need it. In Ontario, most plans are in good shape because they have to comply with the law. Long-term funding is pretty strict now, and deficits must be paid up rapidly. (5)

We still need the Pension Benefits Guarantee Fund. It was set up after the United States guarantee system, and we learned from their mistakes. They guaranteed the benefits of any pension plan that was wound up. A number of companies wound up their pension plan and started another one the next day - threw all the unfunded liabilities on the Pension Guarantee Fund, and walked away. But in Ontario, the Fund recovers its payments from the employer, unless the employer is actually insolvent.

I think there are enough safeguards built into the Ontario Pension Benefits Guarantee Fund, although it did run up a large deficit, mainly because of the bankruptcy of a large agricultural implements manufacturer. Consequently, they've raised the assessments considerably.

It would be wonderful if there were uniformity and less complexity in pension legislation across the country.

Q. *Employer-sponsored pension plans differ widely in terms of employee contributions and benefits. Given the choice of participating in a generous plan requiring high personal contributions or belonging to a non-contributory plan with low benefits, what, in your opinion, is the best option for an employee?*

A. In the old days, I would have said join the high contribution, high benefit pension plan and then stop worrying about your retirement. But now, flexibility is demanded more and more, and a lot of people would prefer to have a non-contributory basic benefit from the employer and more room to put their own money aside. They may put it in registered retirement savings or they may buy a house. Purchasing a house is one of the best provisions for retirement you can possibly make. If you reach retirement and don't have much income, you can take out a reverse mortgage, or you can sell the house, buy an annuity and move into an apartment. So, house purchase, in my view, is for many people as good a retirement provision as an RRSP.

Flexibility is fine, if you've got a certain amount of self-discipline. I've never urged young people below the age of 35 to save hard for their retirement. I think it's just too far ahead. I saw a cartoon once of a severe old businessman behind a big desk facing this young chap applying for his first job. The businessman says, "Young man, when I was your age, all I thought about was hockey and girls, not whether there was an equitable pension plan." I subscribe to that view. Life is too important to start worrying 30 or 40 years ahead of time about what you're going to be living on then.

House purchase, in my view, is for many people as good a retirement provision as an RRSP.

Q. *Employer-sponsored pension plans differ widely in terms of employee contributions and benefits. Given the choice of participating in a generous plan requiring high personal contributions or belonging to a non-contributory plan with low benefits, what, in your opinion, is the best option for an employee?*

A. The situation has improved because the legislation requires earlier vesting and locking in. In 1965, when the Pension Benefits Act started, the requirement for vesting was 10 years of service and age 45. In the 1980s, the vesting rule was amended to 2 or 5 years of participation in a plan, or of service - it varies by province. So, there's been a very considerable increase in the amount of money that is preserved when employees terminate their work. However, the mobile employee ends up with far less than someone with long service in one company.

Q. *There has been a trend towards earlier and earlier retirement in Canada in the last three decades (Frenken, 1991).* [(6)] *Considering improved health and increased longevity, can employers afford to permit workers to leave the labour force in their late 50s or early 60s?*

A. My answer is no. I have no objection to early retirement if the pension is suitably reduced, but the trouble is that people want the full pension, or nearly full, at the age of 55 or thereabouts. I've seen cases where early retirement is not really retirement at all; it's people retiring on pension and promptly taking another job. Their total income may even be greater than if they had stayed where they were. I do not blame the employee, but this is a misuse of pension funds.

We are also quite likely to be short of skilled workers once the baby boomers have gone through. So, I feel that the present trend to early retirement is a great mistake. I don't think we can possibly afford to provide unreduced early retirement in normal circumstances. There are circumstances when you should allow it - where the firm is being downsized and the alternative is to fire people. But, in general, it's extremely costly and socially unnecessary, especially since people are not only living longer but they are living more active lives.

I've never urged young people below the age of 35 to save hard for their retirement. I think it's just too far ahead.

Q. *Some employers have converted their defined benefit pension plans to money purchase arrangements or group RRSPs. Why has this been happening and how do you think this may affect participating employees?*

A. Well, the purported reasons were excessive regulation and the high cost of compliance with provincial requirements, the great difficulty of communicating what all this was about to employees, and the cost uncertainty. In defined benefit plans, the costs are uncertain, and they became even more uncertain when the government said, "You've got to provide vesting after two years instead of ten." Now that was a very real reason. But, the other reason, which I think was just as powerful, was that we ran into a period of very high interest rates. The funds were earning 14%-15% and people saw that they could buy good bonds for up to 18%. A small amount of arithmetic shows that you're far better off taking your contributions and having them in money purchase. So there was a rush to change pension plans from defined benefit to defined contribution. A great many small plans were so changed and a sprinkling of big ones.

I feel that the present trend to early retirement is a great mistake. I don't think we can possibly afford to provide unreduced early retirement in normal circumstances.

Now that interest rates have dropped very considerably, the trend to money purchase seems to have slowed. Currently, fewer than 10% of the members of pension plans are in defined contribution plans, including profit-sharing. So it's still not the predominant type by a long way.

What is interesting is that I've heard of cases where the plans have been switched back from money purchase to defined benefit. In one company, some senior officers were very unhappy when they got statements showing the pensions they would get at retirement. They had high salaries, but the money purchase contributions they had made many years ago, which were the ones that had accumulated most of the interest, were based on low earnings. So the plan was changed to defined benefit. Nevertheless, I don't think employers will generally switch back to defined benefit plans.

Q. *Although the prime objective of RRSP tax-assisted savings is to provide retirement income, large amounts are cashed in each year by persons under 65. In fact, in 1991, $2.1 billion was paid to persons under 55 years of age, virtually all in the form of cash withdrawals. What is your reaction to people cashing in RRSPs long before retirement age?*

A. The original purpose of RRSPs was to provide pensions only - the only way of getting cash out was to die or cancel the contract. But since its institution in 1957, it's evolved. I think savings are to be encouraged, whatever the purpose. People save for retirement, for emergencies, for house purchase. They save to leave an estate, or in case they become sick or unemployed, or to put the kids through university. Nearly all of these activities, at one place or another, have been encouraged by government through some form of tax assistance. I'm quite comfortable with the liberalization of RRSPs to allow people to pull out their money before they're 65. I have some faith in the individual's ability to judge his own needs. I agree there is a temptation to take it out and spend it without too much foresight for the future, but it seems to me there are usually good reasons why people pull out their money.

For example, many women have a baby and take a year off work. They have no income during that year so they withdraw their RRSP with virtually no tax to help support themselves. The money is needed at that time. They think that it is more important to have comfortable provisions for the new baby than to have an extra $100 a month when they're 65. So, I do not feel that this is something that the government should attempt to stop or restrict.

Q. *Statistics Canada has collected extensive data to help measure the economic and social impact of the growth in dual-earner couples. How do you think this trend may affect retirement income?*

A. In the good old days, one pension provided for two people. But, if there are two incomes and you want to maintain the same standard of living, you need both pensions. There is an integration of benefits under the Canada Pension Plan if one spouse dies, (7) but there is no integration of Old Age Security or the Canada Pension Plan if both spouses are still alive. Regarding survivor benefits, the proposal to replace lifetime widows' pensions with temporary resettlement benefits (8) is a good idea. I see husbands and wives becoming more independent of each other. Women are more farsighted today. They worry about their future. The modern trend is for women to have their own personal RRSP and not rely on handouts from a husband. (9)

Q. *Considering the possible implementation of the North American Free Trade Agreement and the prospect of even greater economic integration with the United States than at present, do you think our pension system may have some impact on U.S. pension schemes and, more importantly, could our system be affected by theirs?*

A. Infectious diseases very easily cross the Canada-U.S. border. We caught from the U.S. the idea of a national contributory wage-related pension plan. Later on, we caught the disease of a capital gains tax. They caught from us the pension benefits standards legislation, ERISA, and we are now considerably influencing the health-care debate in the United States. Another example is our RRSPs, which we had going before the United States got their individual pension saving arrangements - IRA and Keogh plans. So there is no doubt that the two countries influence each other.

U.S. legislation has raised the retirement age for social security benefits to age 67 for the full pension, and the early retirement age to 62. It will be in full effect by the year 2027. I think that is very likely to come to Canada because of the ever-growing costs of the Canada Pension Plan. Another thing the U.S. has done is impose an income test on their social security pensions until the age of 70. We have an income test from 60 to 65, but it's a pretty weak one because if you have one year of low income you can start your CPP and it doesn't matter what you earn for the next three or four years, you still keep it.

Q. *Where do you see Canada's retirement income programs headed in the next 20 years?*

A. I think that the Canada Pension Plan will be amended to provide for a full pension at age 67 or 68 instead of 65. We are quite likely to see contributions based on all earnings up to the YMPE instead of earnings between the basic exemption and the YMPE. That would immediately add 10% to the income of the Canada Pension Plan. There have been proposals that employers should pay on all earnings or payrolls even though the benefits to the individuals are only on earnings up to the YMPE. I don't support that idea.

I think we will see some sort of change in spousal benefits because spouses' and survivors' pensions have already been criticized. As women become more independent of men, it's unnecessary to assume that when the husband dies there has got to be a widow who has to be provided for, for the rest of her life.

The modern trend is for women to have their own personal RRSP and not rely on handouts from a husband.

I believe we will see a great growth in registered retirement savings plans, partly because employers will find them more flexible than pension plans; it is also highly likely that there will be regulation of RRSPs beyond what we have now, in order to put in some safety measures to protect employees. I believe we are going to see a big growth of non-registered pension arrangements or employee supplementary pension plans because of the current limit on pensions that can be provided in a registered plan, which comes into effect for an employee earning about $80,000. There are bound to be more and more employees earning well above that limit who will need additional pensions.

Q. *How about the Old Age Security program?*

A. I don't know that I see any very great change. You've got the clawback, which should be preventing things from getting too much out of hand. The Old Age Security program was providing a lot more pension than the Canada/Quebec Pension Plan until recently, but it'll soon be the other way around. So Old Age Security is gradually becoming of secondary importance. [(10)]

Q. *Statistics Canada is the main source of pension and retirement income data. Are you satisfied with* *what's available or are there gaps that should be addressed despite current fiscal restraints?*

A. By and large, I am satisfied. I would like data to come out more promptly. It would be useful if we could get more information about RRSPs on the types of investments made - the amounts paid out - how much is used to buy annuities - how much is withdrawn in cash - and how much goes into RRIFs.

I had some frustration a while ago trying to get reasonable estimates of the amounts in deferred profit-sharing plans. I'd also like to know to what extent the RRSP home purchase plan is being used. But above all, the figures should come out sooner, not several years out of date.

Q. *You personally are still an active participant in the labour force, despite*

A. Well, my first comment is that I don't play golf so I have more time for other things. I still work at the office from time to time. I like to meet old friends and do a certain amount of voluntary work. I think everyone should find some useful activity. I know a great many retirees who volunteer to work in hospitals, community centres, cultural organizations, and so forth. [(11)] To settle down in a deck chair or play golf for the rest of my life does not appeal to me.

Definitions

The **Canada and Quebec Pension Plan** (C/QPP) is an earnings-related retirement program introduced in 1966. It provides minimum levels of retirement, disability and survivors' benefits for Canada's workforce. The CPP covers workers outside Quebec and is administered by the government of Canada, while the QPP covers Quebec workers and is administered by the government of that province.

Annual contributions are required on earnings above a basic exemption amount and below the year's maximum pensionable earnings or YMPE. In 1993, no contributions were required on earnings below $3,300 or above $33,400. For further information on C/QPP contributory earnings and the increasing contribution rate, see Frenken (1993).

Old Age Security (OAS) is a universal benefit unrelated to earnings, paid monthly by the government of Canada to all Canadians aged 65 and over meeting minimum residency standards.

Guaranteed Income Supplement (GIS) payments are provided to OAS recipients with little or no other income. Eligibility and amount are determined by the amount of other income.

Pension benefits standards legislation protects the rights of members of employer-sponsored registered pension plans (RPPs) and sets minimum standards in such areas as vesting and funding. First introduced in Ontario in 1965, it has since been enacted, with some variations, by all provinces and the federal government.

Vesting refers to the right of RPP members who terminate employment, to benefits from their pension plans. These benefits may be **locked in**, in which case the employee cannot receive lump sum refunds, but must receive benefits in the form of a pension at retirement. Pension benefits standards legislation initially mandated vesting and locking in at age 45 and ten years of service, but in most provinces today both are required after two years of service or plan participation.

Funding a pension plan is the process of setting aside money on a systematic basis to pay for retirement benefits. **Pay-as-you-go** funding entails the paying of benefits as they fall due. It is not funding in reality, since no fund is accumulated.

Solvency refers to a test required under pension benefits standards legislation that ensures the adequate funding of a pension plan. It is particularly applicable to defined benefit plans. Any deficits that occur during the normal operation of such plans (**experience deficiencies**) must be liquidated by the employer through additional contributions.

A **defined benefit plan** is a pension plan that specifies the benefits members will receive at retirement or termination from the plan. It does not define the employer's contributions. Instead, employer contributions are determined by calculating the costs of providing these benefits.

A **defined contribution or money purchase plan** is a plan that specifies the employer's contributions (and employee's, if any). Members' benefits consist of accumulated contributions plus interest earned at the time of retirement or termination from the plan.

Registered retirement savings plans (RRSPS) are arrangements under which persons with earned income may save on a tax-assisted basis. They may be individual plans or group arrangements.

Registered retirement income funds (RRIFs) are one of three methods used to obtain RRSP benefits. The others are cash withdrawals and conversions to annuities. When cashing in an RRSP or converting it to an annuity, the assets have to be liquidated, while an RRIF can retain the same investments as the RRSP. Although it requires minimum annual disbursements, it has much greater payment flexibility than an annuity.

The **Employee Retirement Income Security Act** of 1974 (ERISA), modeled after the Canadian pension benefits standards legislation, set out to protect the rights of pension plan members in the United States. It also established an insurance program to guarantee workers receipt of pension benefits should their defined benefit plan terminate.

Individual retirement accounts (IRAs) are retirement savings programs for individuals in the United States, very similar to Canadian RRSPs, but with much lower contribution limits and greater restrictions on withdrawals.

Keogh plans are programs that allow self-employed individuals in the United States to make tax-deductible contributions to a qualified pension or profit sharing plan, but with certain restrictions and limitations.

Notes

Note 1
The companion Quebec Pension Plan (QPP) came into effect on that date as well. All references to the CPP in this article can also be applied to the QPP (see *Definitions*).

Note 2
Taxfilers with income in excess of $53,215 (including OAS benefits) in 1992 had to repay part or all of their OAS when filing their tax returns.

Note 3
For information on the possible impact of C/QPP contribution increases on RPPs, see Frenken (1993).

Note 4
The Canadian Life and Health Insurance Association Inc. conducts an annual survey of all its member companies, requesting information on group retirement plans, RRSPs, RRIFs and annuities (CLHIA, 1993). The 657,000 figure reflects some double counting since some group RRSPs are funded through contracts with more than one insurance company.

Note 5
Employers with experience deficiencies (see *Definitions*) in their defined benefit pension plans must make additional contributions to liquidate these deficiencies within five years.

Note 6
Results from Statistics Canada's General Social Survey show that in 1989 just over one in three Canadians supported the idea of mandatory retirement. Yet, 43% wanted to retire before age 65 (Lowe, 1991).

Note 7
A CPP pension payable to a surviving spouse aged 65 or over is equal to 60% of the retirement pension which would have been payable to the deceased contributor. A pension payable to a spouse under 65 is composed of a flat-rated amount plus 37.5% of the actual or imputed retirement pension of the deceased. A surviving spouse may receive both the spouse's pension and a self-earned retirement benefit. However, the combined benefit may not exceed the maximum retirement pension payable for the year the contributor retires.

Note 8
It has been proposed to change small lifetime spousal pensions to much larger temporary benefits that would allow survivors time to adapt to the new situation or find employment.

Note 9
In 1981, 31% of RRSP contributors were women; by 1991, that proportion had increased to 42% (Frenken and Maser, 1993).

Note 10
The income at which the clawback begins is not fully indexed. So, the clawback will apply to more and more people in the future and the OAS will, if this continues long enough, become of significance only to low income people.

Note 11
According to the Survey of Volunteer Activity, 582,000 persons aged 65 and over (22% of the population in this age group) volunteered for an organization at least once in the November 1986 to October 1987 period.

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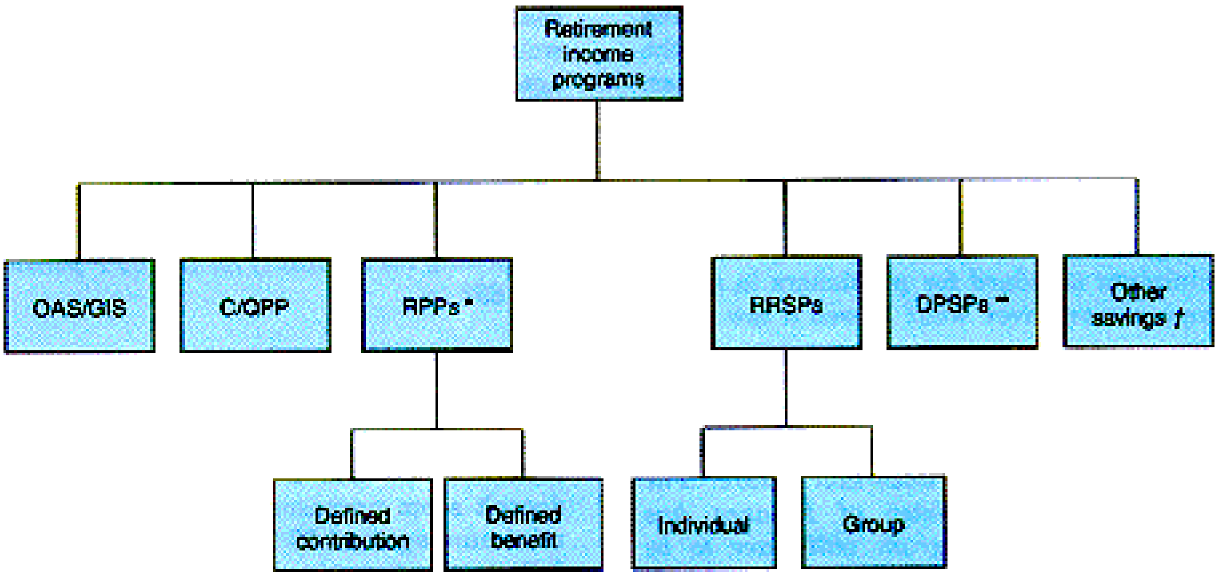
Canada's retirement income system



* *Employer-sponsored registered pension plans*
** *Deferred profit sharing plans*
† *Includes home equity, investments and rental property.*