

Pension fact or fiction?

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There is a perception in the Canadian pension and benefits industry that there have been widespread conversions from defined benefit registered pension plans (RPPs) to defined contribution arrangements, particularly money purchase RPPs and group RRSPs. If this is the case, to what extent have workers been affected? Specifically, has there been an extensive reduction in the number of jobs providing a defined benefit RPP in recent years? This study suggests otherwise. (For definitions of defined benefit and defined contribution plans see *About the data*.)

Changes in the proportion of jobs with high quality (defined benefit) pension plans¹ would have significance beyond the pension and benefits industry. It would influence trends in Canadian labour markets generally. For example, some analysts consider the presence (or absence) of a high quality RPP to be an indication of a “good” (or “bad”) job. Stability of the defined benefit RPP coverage rate would indicate that good jobs are not disappearing at the rate some commentators have suggested.

Why switch?

Numerous articles have highlighted employers’ (and to some extent employees’) growing disaffection with defined benefit arrangements and some have provided anecdotal evidence of conversions by employers to defined contribution plans, including group RRSPs, profit sharing plans and other savings vehicles such as employee stock ownership plans. Among the reasons given for such

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About the data

The data are taken from a variety of sources, but mainly the Labour Force Survey (LFS) and Labour Division’s Pension Plans in Canada (PPIC) database. The latter covers all employer-sponsored registered pension plans (RPPs) in Canada, their membership and characteristics. It is updated annually with information obtained from the federal/provincial pension supervisory authorities.

Since the effective date of most new plans and of amendments is January 1 and since plan terminations most often occur on December 31, the annual data reflect the information at January 1. Each year’s membership count, however, is taken at December 31 or the nearest fiscal year-end, although in some cases all persons who were members at any time during the year, or who were members on temporary layoff at year-end, are included. Because of these inclusions, LFS data were averaged over the preceding 12 months. Thus, for example, for 1994 coverage rates the January 1994 PPIC data are compared with the 1993 LFS average of paid workers. (Paid workers only are included, since self-employed owner-operators of unincorporated businesses, the unemployed and unpaid workers are unable to participate in an RPP.)

Among the PPIC characteristics are the formulas used to define the retirement benefits of the members. There are two basic types of formula: defined benefit and defined contribution (also called money purchase). Under

changes are the extensive legislative requirements and additional administrative costs of defined benefit plans, as well as the forfeiture of retirement savings by workers frequently switching jobs in a highly mobile workforce.²

Some limited data obtained by Statistics Canada from the pension supervisory authorities in New-

the former, the member’s pension is specifically defined, most frequently as a percentage of earnings. Employer contributions are made as required to maintain the actuarial soundness of the plan. The latter has no specific benefit formula, but defines the employer contributions (and those of the employee, if required). Contributions accumulate, earn investment income and provide a pension at retirement. A growing number of employers have set up hybrid plans, which allow the employee to select either a defined benefit or a defined contribution pension. Since most members prefer defined benefits, these plans have been coded as defined benefit arrangements.

Defined contribution RPPs, group RRSPs and other savings plans sponsored by employers, both registered and non-registered, are often considered as one and the same by the pensions industry, but only the first type is included in the PPIC database.

In this study, the public sector includes all employees of the three levels of government – federal, provincial/territorial and municipal – as well as employees of enterprises, agencies, boards and commissions operated or sponsored by these governments; and workers in public hospitals and educational institutions, excluding universities. The private sector forms the balance. For further information on the PPIC database, contact the Pensions Section of the Labour Division at (613) 951-4034.

foundland, Nova Scotia, Manitoba, Saskatchewan, Alberta and British Columbia show that for 900 of 1,650 recently terminated RPPs in these jurisdictions a reason for termination was provided. Of these 900 plans, 22% (covering 61% of the 26,900 members concerned) were replaced by a new RPP (most likely a defined contribution plan)

or a group RRSP.³ Similarly, a recent study for the Society of Actuaries and the Canadian Institute of Actuaries, using data extracted from the files of the Pension Commission of Ontario, found that 35% of the 127 plans terminated between 1988 and 1993 (covering 37% of the 23,100 members affected) had been replaced by a defined contribution RPP or a group RRSP.⁴

Increased defined contribution coverage

While these data show that significant conversions from defined benefit to defined contribution plans have taken place, there is also ample evidence of considerable growth in the number of workers covered by some types of defined contribution arrangements.⁵ For example, membership in defined contribution RPPs grew by 56% from 1986 to 1994. However, even though these plans are more numerous, they have always covered a relatively small number of workers. In 1994, 55% of the 15,750 RPPs in effect were defined contribution, but they covered only 10% of the 5.2 million RPP members. This low rate is to some extent influenced by the public sector, where defined contribution plans are virtually non-existent. But even in the private sector only 15% (421,000) of all 1994 RPP members had a defined contribution formula and they represented only 4.6% of paid workers in that sector. (For definitions of public and private sectors see *About the data*.)

While the total number of workers covered by group RRSPs is not known, there are indications that it has grown considerably over the last 10 years. According to the Canadian Life and Health Insurance Association (CLHIA), in 1985 life insurance companies administered the assets for 7,500 group RRSPs with 159,500 members. By 1994, the number of plans had increased to nearly 18,000, covering almost

710,000 individuals (CLHIA, 1995). Though it is not possible to determine the proportion of total group RRSP participation this 710,000 represents, membership in similar plans administered by other financial institutions, as well as those self-administered by employers, has surely grown in similar fashion.

The number of participants in other defined contribution arrangements appears to be much less significant. Deferred profit sharing plan participation, which has never been very large, amounted to roughly 350,000 individuals in 1993 (Statistics Canada, 1996) and, while there are no data on membership in non-registered employer-sponsored savings vehicles such as employee stock ownership plans, their coverage is likely not extensive, in part because they offer no tax assistance.

Little change in defined benefit coverage

Has the growth in defined contribution membership been at the expense of defined benefit coverage? The percentage of paid workers covered by defined benefit RPPs actually changed very little in recent years, from 40% in 1986 to 39% in 1994 (Table). However, this rate may be misleading, because of the influence of the public sector, where changes to plan designs are rarely made. In fact, the proportion of public sector workers covered by defined benefit plans increased from 82% in 1986 to 88% in 1994. At the same time, the share of private sector paid workers participating in defined benefit plans decreased over this period, though only marginally, from just over 27% to 25%.⁶

Table
RPP membership by type of plan and sector

	All plans *		Defined benefit	
	Members	Coverage **	Members	Coverage **
	'000	%	'000	%
Both sectors				
1986	4,668	43.6	4,296	40.1
1988	4,845	42.5	4,430	38.8
1990	5,109	42.4	4,634	38.4
1992	5,318	45.0	4,776	40.4
1994	5,215	44.2	4,645	39.3
Public sector				
1986	2,086	83.6	2,043	81.9
1988	2,172	88.0	2,120	82.3
1990	2,266	89.7	2,212	87.5
1992	2,555	95.1	2,464	91.7
1994	2,461	92.1	2,360	88.4
Private sector				
1986	2,582	31.4	2,252	27.3
1988	2,673	30.3	2,310	26.1
1990	2,844	29.8	2,422	25.4
1992	2,764	30.2	2,312	25.2
1994	2,759	30.2	2,285	24.9

Sources: *Pension Plans in Canada database, Labour Force Survey and Public Institutions Division*

* Includes combination and other hybrid plans, as well as defined benefit and defined contribution plans.

** Number of members as a percentage of total paid workers. Members residing in the Yukon and Northwest Territories and outside Canada are excluded from this calculation, since the Labour Force Survey does not cover these areas.

Job losses and new plans

This small decline is even more surprising when factors other than switches from defined benefit plans are considered. Extensive layoffs in industries that have traditionally had high defined benefit coverage rates would have contributed to the decline. For example, from 1986 to 1994 the mining, quarrying and oil well industries lost 16,400 RPP members; transportation, communication and other utilities dropped 32,100 members; and manufacturing in primary metals, fabricated metals, and machinery together lost 49,800 RPP members. Considering the extent of these job losses, it would appear that some offsetting gains in defined benefit plan coverage were made through jobs created in other industries.

In fact, there was a preference for defined benefit plans in new RPPs registered from 1986 to 1994, although this preference was much weaker than it had been. In 1994, of the 260,000 workers participating in the 4,400 new plans established during that period, 56% (146,000) had a defined benefit formula and the remainder, a defined contribution formula. Despite the addition of these new plans, 89% of all RPP members had a defined benefit formula that year.

Growth in defined contribution arrangements, particularly the surge in group RRSPs, was not solely at the expense of defined benefit RPP coverage. Indeed, group RRSPs have been adopted by employers either as a supplemental program to an existing RPP or in lieu of an RPP altogether. This latter development is important when the extent to which workers are covered by some form of employer-sponsored pension program is considered. The 30% private sector RPP coverage rate presents only part of the picture. Overall coverage is likely much higher. Furthermore, the defined contribution share of total retirement savings

may be increasing more rapidly than that generated by defined benefit plans.

A somewhat different picture in the United States

The perception of a mass movement away from defined benefit plans may have arisen from observations of this development in the United States. From 1980 to 1987, the percentage of American private sector workers covered by a defined benefit pension plan decreased from 38% to 31%. At the same time, the percentage of workers with defined contribution coverage increased dramatically. While many of the new defined contribution arrangements were supplemental plans used by employers to top up benefits accrued in "primary" programs, the coverage rate of primary defined contribution plans increased from 8% of private sector workers in 1980 to 15% in 1987.⁷

Summary

The percentage of private sector workers covered by Canadian defined benefit RPPs has dropped only marginally in recent years, despite numerous reports of a growing disenchantment with these plans and a significant drop in coverage in the United States. It might be argued that the small decline is surprising, considering the conversions from defined benefit to defined contribution arrangements that have taken place, the loss of jobs in industries that historically have had high defined benefit coverage, and the greater preference for defined contribution arrangements in new RPP registrations than has been the case traditionally. However, the seemingly dramatic growth in group RRSPs is an important consideration when the percentage of workers with some form of pension provision is calculated, and may, over time, significantly reduce the defined benefit share of retirement savings.

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Notes

1 Most defined benefit RPP members tend to accumulate higher retirement pensions than those in defined contribution arrangements, assuming similar earnings and length of service. For a detailed analysis of benefit levels generated by different types of RPP, see Frenken (1995).

2 For an explanation of defined benefit plans' disadvantages to employers see Guay (1993) and Simpson (1991); for an explanation of the loss of both pension savings and RRSP opportunities when defined benefit plan members terminate before reaching the age of retirement, see Adams (1995) and Guay (1995); and for anecdotal data on transfers from defined benefit to defined contribution plans see Bak (1995), Heale (1993) and Schiele (1993).

3 These data are supplemental information contained in the Pension Plans in Canada database (see *About the Data*).

4 For further details contact Michael Sze, Consulting Actuary, Hewitt Associates, Toronto, at (416) 225-5001.

5 Increases in assets held for these plans are also an indicator of the growth of defined contribution arrangements. *Benefits Canada's* most recent Survey of Money Purchase Plan Suppliers found a total of \$30 billion held by financial institutions in Canada for defined contribution RPPs, group RRSPs and deferred profit sharing plans as of June 30, 1995, an increase of nearly \$7 billion over the amount recorded one year earlier (Bak and Grossi, 1995).

6 These rates are slightly different from those previously published by Labour Division (Statistics Canada, 1996) for a number of reasons. These figures exclude members in the Yukon and Northwest Territories and those outside Canada, since these regions are not included in the Labour Force Survey. Also, the contents of the public and private sectors differ somewhat.

7 Defined contribution arrangements include defined contribution pension plans, individual retirement accounts or IRAs (similar to individual RRSPs), so-called "401(k)" plans (similar to group RRSPs) and employee stock ownership plans. For a detailed description of these plans and the trend toward their adoption, see U.S. Department of Labor (1992).

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