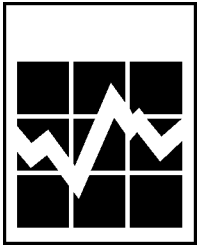


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# PERSPECTIVES

ON LABOUR AND INCOME

**OCTOBER 2000**

Vol. 1, No. 1

■ **IN FOR THE LONG TERM:  
PENSION PLANS OFFERED  
BY EMPLOYERS**



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# Highlights

*In this issue*

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## ■ In for the long term: pension plans offered by employers

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- Over 5 million Canadian employees belonged to an employer- or union-sponsored pension plan in 1998. The total assets of these plans, also known as registered pension plans (RPP), exceeded \$644 billion, much more than those of the public Canada and Quebec Pension Plans and individual registered retirement savings plans combined.
- One form of RPP, the “trusted pension fund,” has had great success investing contributions in the stock and bond markets. Investment income from these sources grew from \$1.6 billion in 1976 to \$20.5 billion in 1998, a more than 12-fold increase. The income from these investments now far exceeds the combined value of employer and employee contributions.
- Trusted pension fund managers also buy and sell stocks. The industry as a whole has shown a net profit from these transactions for many years, and since 1990 the amounts have grown significantly, reaching \$23.5 billion in 1998.
- Fund managers are legally obliged to ensure benefits for future retirees. The asset mix and investment strategies they adopted in the 1990s virtually guarantee that this obligation will be met.

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*Perspectives*

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# In for the long term: pension plans offered by employers

Robert D. Anderson

Most people are familiar with some aspects of Canada's retirement income programs. The federal and Quebec governments are responsible for the Canada and Quebec Pension Plans (C/QPP), and the choices that the responsible ministers make are subject to legislative and public debate. Registered retirement savings plans (RRSP) are another well-known element of retirement planning.

People are less familiar with another form of retirement saving—the pension plans offered by many employers or unions—yet for millions of Canadians, benefits from these plans will be one of their main sources of retirement income. Money in these plans is invested in a wide range of financial and capital markets to ensure that benefits will be available to future retirees.

This article situates these pension plans within the context of the other major retirement income programs, and describes the investment strategy these plans follow.

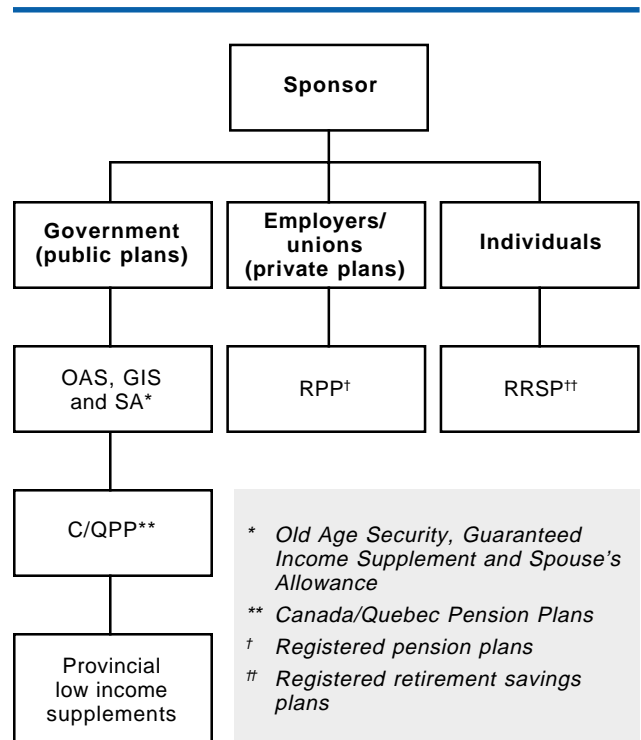
Pension plans offered by employers or unions are frequently referred to as “private” pension plans to distinguish them from the public C/QPP (Figure). They are also called registered pension plans (RPP), as they must be registered with the Canada Customs and Revenue Agency (CCRA) and one of the pension supervisory authorities. These plans are provided by employers or unions in both the public and private sectors.

## Relative importance of the programs

Two different pictures of the relative importance of the programs emerge, depending on whether they are viewed in terms of number of contributors, or value of assets<sup>1</sup> (Chart A). In terms of contributors, the public

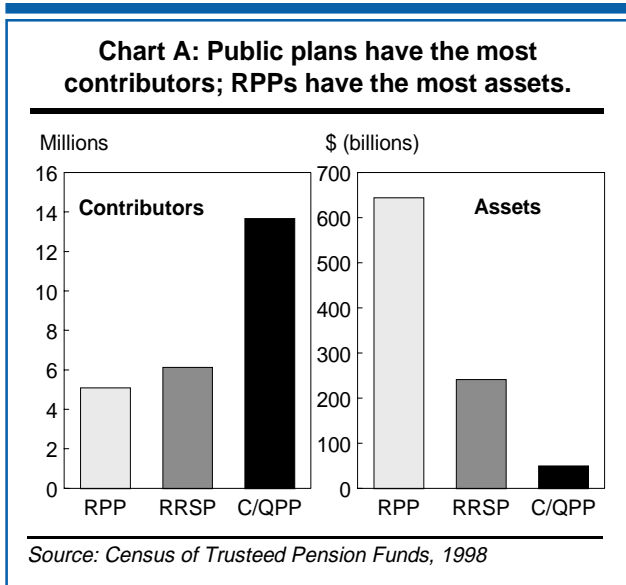
*Robert D. Anderson is with the Income Statistics Division. He can be reached at (613) 951-4034 or robert.anderson@statcan.ca.*

Figure: Retirement income programs



plans (C/QPP) are by far the largest, with 13.7 million persons having contributed in 1998. Public plans are compulsory for employed workers. Contributors to RRSPs numbered about 6.1 million, showing the popularity of these widely available retirement planning products. Finally, over 5 million persons were covered by RPPs.

When programs are viewed in terms of assets accumulated, however, another picture of their relative importance appears. The C/QPP—with the most contributors—had assets of under \$50 billion at the end of 1998, the least of the three programs. Assets accumulated in RRSPs amounted to \$241 billion, and those in registered pension plans—with the fewest contributors—reached \$644 billion.<sup>2</sup>



The value of assets increased 138% for RPPs and 200% for RRSPs over the 1988-to-1998 period. In contrast, the combined assets in the C/QPP declined (Table).

### Funding arrangements

The funds in RPPs are most commonly managed through a trust arrangement. Most of the remaining monies in these plans are held in consolidated revenue

arrangements administered by the federal and some provincial governments. They cover most federal public servants, the RCMP and the military. Insurance company contracts and Government of Canada annuities are also used by some RPPs, although these amounts are relatively small. What all registered pension plans have in common is their tax treatment by the CCRA: money going into the plans is not taxed, but benefits paid out are. The plans differ with respect to their funding arrangement, their terms and conditions, and their investment of funds.

A funding arrangement is defined through a legal document outlining the obligation of the funding agency (for example, trust company or insurance company) with respect to the pension plan. The instruments are registered with the appropriate pension authority and/or the CCRA. The terms of the plan specify, among other conditions, who is eligible or required to join the plan and who must pay contributions, what benefits are paid out and under what conditions, and how the funds' assets may be invested.

Like the C/QPP, many (though not all) RPPs require contributions from employees. "Contributory" plans cover about 73% of total RPP membership, including virtually all members of public sector plans. Non-contributory plans are offered almost exclusively by private sector employers.

**Table: Accumulated assets in retirement income programs, at December 31**

	1988		1990		1992		1994		1996		1998	
	\$ (billions)	%	\$ (billions)	%	\$ (billions)	%	\$ (billions)	%	\$ (billions)	%	\$ (billions)	%
<b>Total</b>	<b>402.1</b>	<b>100.0</b>	<b>489.2</b>	<b>100.0</b>	<b>588.5</b>	<b>100.0</b>	<b>691.1</b>	<b>100.0</b>	<b>803.5</b>	<b>100.0</b>	<b>935.0</b>	<b>100.0</b>
C/QPP	50.8	12.6	55.0	11.2	56.9	9.7	54.4	7.9	51.6	6.4	49.4	5.3
RPP	270.8	67.3	324.2	66.3	384.3	65.3	452.7	65.5	528.1	65.7	644.4	68.9
Trusteed	156.1	38.8	198.1	40.5	235.4	40.0	290.8	42.1	351.1	43.7	438.3	46.9
Government	86.3	21.5	95.0	19.4	112.8	19.2	121.6	17.6	137.0	17.0	160.7	17.2
Other*	28.3	7.0	31.1	6.4	36.1	6.1	40.4	5.8	40.0	5.0	45.4	4.9
RRSP**	80.5	20.0	110.1	22.5	147.3	25.0	184.0	26.6	223.8	27.9	241.2	25.8

Source: Census of Trusteed Pension Funds

Note: Dollar values are not adjusted for inflation.

\* Insurance company contracts and Government of Canada annuities.

\*\* Reserves in self-administered RRSPs are not included.



## Fund investments

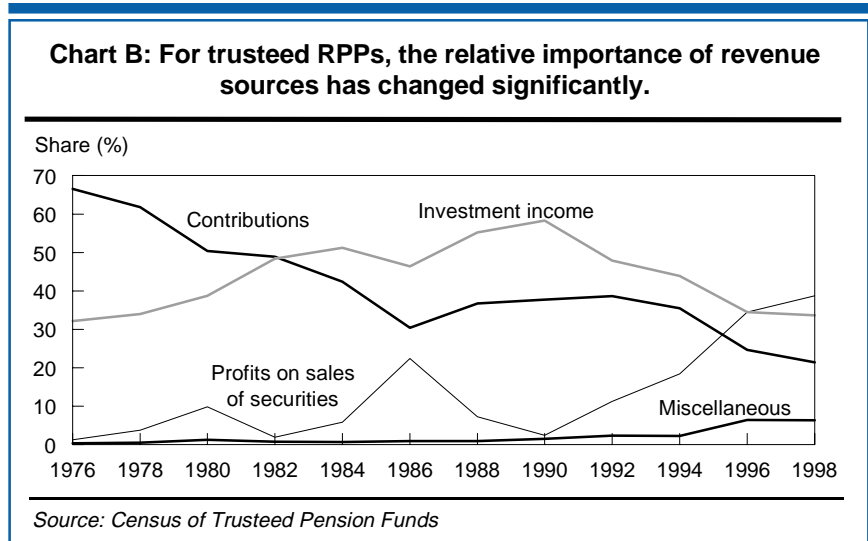
The assets of funds governed by a trust agreement (called “trusteed pension funds”) are invested in the financial and capital markets. Until recently,<sup>3</sup> the funds in consolidated revenue arrangements were not: employee contributions were part of general tax revenues and were not invested or set aside for future benefit pay-outs.

The remainder of this article focuses on trusteed pension funds, which represent 68% of all RPP assets. It is these funds that are invested in the financial and capital markets. Their growth explains most of the increase in the total value of RPPs.

The assets available from trusteed pension funds for investment in the financial markets topped \$438 billion in 1998. These funds have various sources of revenue in addition to employee and employer contributions: investment income from bond interest and stock dividends; profits from the sale of securities (stocks and other forms of equity investment); and real estate, mortgage and short-term investments. The importance of some of these sources has changed dramatically over time, reflecting varying economic forces and funding strategies (Chart B).

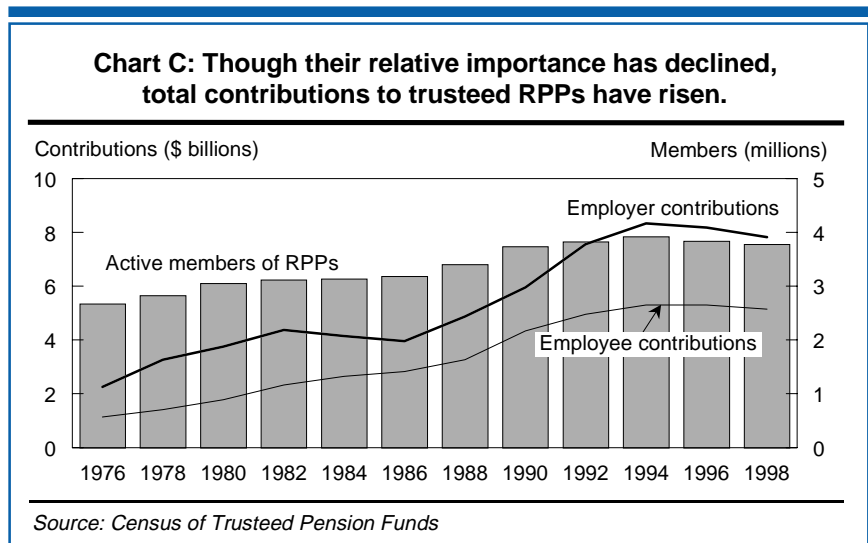
Perhaps the most notable change over the last two decades was the decline in the relative importance of contributions as a revenue source. That being said, contributions nearly quadrupled during the period under review (1976 to 1998), from \$3.4 billion to \$13.0 billion (Chart C).

The explanation for the decline in the relative importance of contributions lies in the more rapid increase of the other revenue

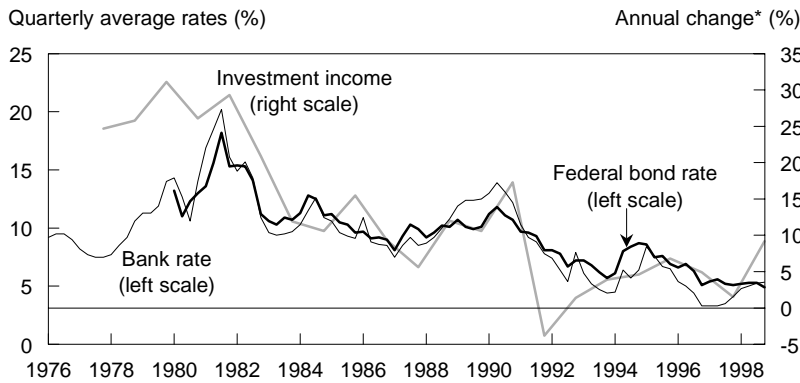


sources. For example, investment income (mostly bond interest and stock dividends) grew from \$1.6 billion in 1976 to \$20.5 billion in 1998, a more than 12-fold increase. It became the largest single source of revenue in 1983, exceeding employer and employee contributions combined. The value of investment income increased every year over the period except 1991, when it declined slightly.

Investment income is closely related to bond yield rates, which tend to track bank rates. Thus, it increases more during periods of high bond yields than in years of low bond yields. For example, rising bond yield rates in the early 1980s led to large annual increases in investment income; conversely, falling bond yield rates throughout most of the remainder of the 1980s slowed the growth of the funds' investment income. In recent years



**Chart D: For trusted RPPs, investment income is closely related to bond yield rates.**



Sources: Quarterly Survey of Trusted Pension Funds; CANSIM  
\* Fourth quarter over fourth quarter.

bond yield rates have been relatively low, dampening annual growth in the investment income of trusted pension funds (Chart D).

Trusted pension fund managers also buy and sell stocks. The industry as a whole has shown a net profit from these transactions for all the years under review, and the amounts have grown significantly since 1990, reaching \$23.5 billion in 1998. A major turning point

occurred in 1996, when profits from the sale of securities (stocks) contributed the same amount (\$18.9 billion) to revenues as yields from investment income.

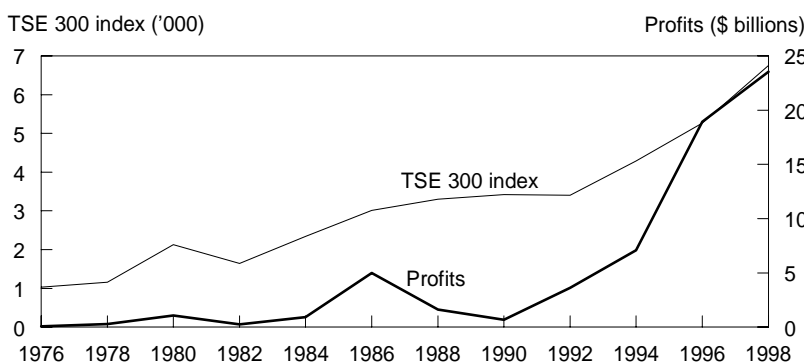
### Security and growth

Trusted pension fund managers are obliged by law to ensure that assets are not at risk. They must operate in a prudent manner in making investment decisions. Typi-

cally, a fund would have about 35%-to-40% of its assets in bonds, 35%-to-40% in stocks or pooled equity funds, and the remainder in cash, short term investments, real estate or mortgages. The allocation of the 35%-to-40% invested in the stock market requires a strategy specifically oriented to providing retirement benefits, because that is the financial objective of pension fund investment. One strategy for investing in the stock market is to match the composition of an index such as the TSE 300. In other words, a fund manager would purchase stocks in the communications, transportation, retail and other sectors in the same proportion as they are represented (weighted) in the index. This is because over the long term all major indexes have increased in value. However, the composition of the index also changes over time, meaning that the asset mix of the fund needs to be reviewed every few years. This strategy, among others, has been widely adopted by trusted pension fund managers.

QPP funds have for some time been invested in the financial and capital markets. Only recently, however, have monies in the CPP been directly invested in equities.

**Chart E: If managers of trusted funds sell during periods of rising market indexes, profits rise.**

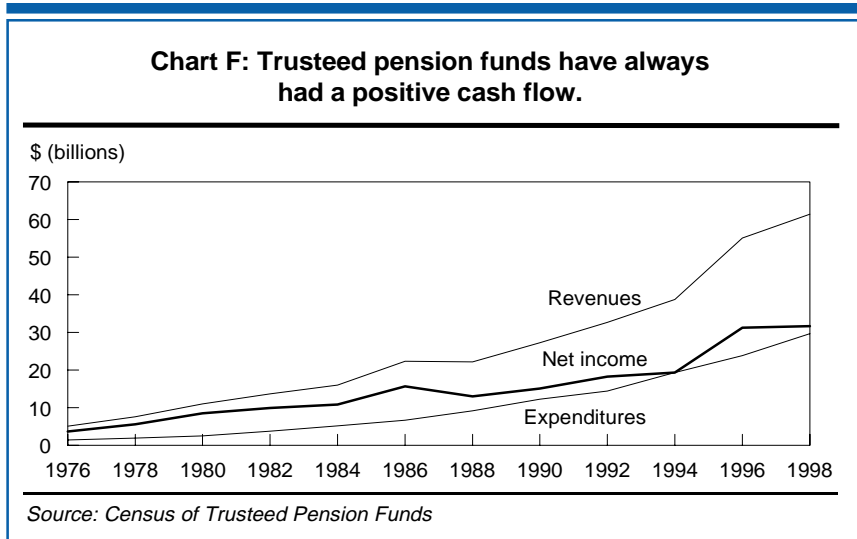


Sources: Census of Trusted Pension Funds; CANSIM

### When to buy and sell

If fund managers decide to sell stocks to earn profits, the annual growth of these profits will track the annual growth of a stock market index (Chart E). Both the TSE 300 and the profits of the funds have been climbing steadily since 1992. By 1994, fund managers were selling off at a rapid rate to take advantage of rising stock prices. They would then re-invest the profits to buy, and then sell, more stocks.





These decisions to buy and sell are made over years, not days or months. Fund managers are not “market timers”; that is, they do not look for short-term gains or attempt to make profits on the day-to-day movement of stock prices, even though they may well be able to “afford” significant losses over a short term. Investing for retirement, whether by pension fund managers or by individuals, means being in for the long term, regardless of current market conditions such as unprofitable economic sectors or depressed overseas stock prices. The strategy of long-term investment in the stock market, combined with investment in the more traditional bond markets, is designed to provide the security that future beneficiaries require, while still providing growth in the value of fund assets.

### Positive cash flow

The largest component of trusteed pension fund expenditures is benefits to retired members. Further expenditures relate directly to managing the funds’ assets, namely, administration costs. Also, some sales of stocks incur losses. Nonetheless, the trusteed pension fund sector has always had a positive cash flow—revenues have always far exceeded expenditures (Chart F).

### Summary

Registered pension plans constitute, in terms of dollars, the largest component of the retirement income system. The largest proportion of the monies in RPPs is held in trusteed pension funds and is actively invested in the financial markets. These investments have generated significant revenue for the funds. In the 1970s, revenues

from contributions were the driving force behind the growth in fund assets, followed by investment income during the high-interest period of the 1980s and early 1990s. In recent years, profits from the sale of stocks have taken over as the largest source of fund revenue.

Whether profits from the sale of stocks will continue to drive net income depends upon stock prices. Trusteed pension fund managers are required by law to ensure the viability of the fund, so contributions and low-risk forms of investment income such as bond interest and stock dividends will remain major sources of fund revenues, providing a healthy cushion against stock market volatility and virtually guaranteeing retirement benefits for plan members.

### Perspectives

#### Notes

- 1 The figures are for 1998, the latest available for all programs.
- 2 All dollar values are in current dollars (that is, unadjusted for inflation).
- 3 In April 1999, the CPP Investment Board began investing in an index fund composed of companies listed on the TSE 300.

#### Reference

Statistics Canada. *Trusteed Pension Funds, Financial Statistics*. Catalogue no. 74-201-XPB. Ottawa, 2000.