Intelligence MEMOS

From: Robert Brown and Stephen A. Eadie
To: The Canadian pension industry
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Re: COMMON GROUND IN THE PENSION DEBATE

With traditional pension models largely falling short of their goals, the time is right for a new pension paradigm that better serves the needs of all Canadian workers. It is time for the pension industry to go beyond the tired defined-benefit versus defined-contribution pension debate and focus on the model pension of the future.

In the neverending debate about finding an optimal pension model, many proponents start the discussion at extreme ends of the pension model paradigm. At one extreme is a traditional, fully guaranteed defined-benefit (DB) pension plan. In this plan, all of the risks are born by the plan sponsor given that plans are fully funded. While such plans are growing rare today that is the starting point for many in this debate. At the other extreme is a traditional defined-contribution (DC) plan. In this plan, all of the risks are borne by the worker participant. This, again, is a starting point for many in the pension model debate.

Many classic DB and classic DC pension plans have not achieved their goals. Our recent C.D. Howe Institute paper argues they should be replaced by pension plans that facilitate sharing of risks among all willing stakeholders, whether the plan is characterized as DB or DC.

In the paper, we propose, as a starting point for all pension-plan model discussions, a “Common Ground.”

If one is of a pro-DB persuasion, then the Common Ground model would be a Pooled Target Benefit DB pension plan. If one is of the pro-DC persuasion, then the starting point will be a large Collective DC plan. These plans have a lot in common and, since they can provide equivalent benefits for the same contributions, they should be viewed as being actuarially equivalent.

The common ground would include:
- Pooling: across multiple employers to reduce risk for plan sponsors and lower contributions from members;
- Target benefits: to share risks between sponsors and members;
- Scale: the optimum asset size would be $1 billion and up;
- Independent Management Boards: to ensure good governance.

Thus, by finding the common ground in the great pension debate, we have also identified models for pensions that can provide all Canadian workers with significant retirement income security. With that accomplished, the question becomes whether one wants a bit more of a DB flavour and why, or whether one wants a bit more of a DC flavour, and why.

This should make arriving at a consensus plan model much easier for all. We conclude that policies encouraging larger collective, pooled pension plans governed by independent management boards are badly needed to better serve Canadians. Such solutions are common in the public sector but need to be encouraged in the private sector.

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