

Intelligence MEMOS



From: William B. P. Robson
To: Canada's Pension Regulators
Date: February 9, 2018
Re: **ONTARIO'S LATEST TURN IN THE VICIOUS CIRCLE OF GOVERNMENT PENSION GUARANTEES**

The trauma of pensioners left short when the sponsor of an underfunded plan goes bust prompts regular calls for government pension backstops. In Ontario, the only Canadian jurisdiction with such a program, these pressures are leading the government to raise the guaranteed payment from its Pension Benefits Guarantee Fund from \$1,000 to \$1,500 a month – even as the province eases the funding rules that ought to keep plans from needing the backstop.

Like the United States and the United Kingdom, where the high premiums needed to support failed and failing plans penalize well run plans, Ontario's experiences shows how government backstops for failed pensions exacerbate the problem their advocates intend to solve.

In theory, a pension guarantee agency could run on genuine insurance principles. It could charge each participant premiums related to the likelihood that the plan would fail and the likely size of the shortfall if it did, pooling risks without encouraging underfunding by subsidizing irresponsibly run plans at the expense of good ones.

But real-world pension guarantee agencies don't do that. Just as politics dictates that employment insurance subsidizes firms more prone to layoffs at the expense of those less prone, and workers' compensation programs subsidize dangerous industries at the expense of safe ones, pension guarantees support bad plans at the expense of good ones.

And risk assessments inevitably rest on experience to date, which means risk-adjusted premiums will be higher for plans already in trouble. So the agencies face a dilemma: charge premiums too low to cover their obligations; or charge rates high enough to cover looming payouts – which encourages employers who are less likely to use the backstop to wind up their plans.

They also exacerbate the temptation for managers of plans in trouble to shoot for the moon with their investments. Aggressive investments exacerbate mismatches between plan assets and their payment obligations – mismatches that fund premiums ignore – amplifying swings in plan fortunes and the damage when those bets do not pay off.

The US pension backstop's record unfunded liability of almost US\$80 billion earned it a "high risk" rating in the General Accounting Office's latest report. The collapse of contractor Carillion last month will drop some £800-900 billion of unpaid pensions into the UK scheme – its biggest hit yet – which will push premiums up, further stressing weak plans, and making all plans more expensive for their sponsors.

These experiences are not accidental: they are inherent in any attempt to prop up unsound pension plans. And it is not accidental that Ontario is relaxing its funding rules, even as it hikes the payouts – and the premiums – in its fund. We can safely predict more plan failures, and even higher premiums, in Ontario in the years ahead.

If we want well-funded pensions, government backstops are not the way to go. Experience shows they make a bad problem worse.

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