Tracking the defined-benefit pension's decline in the private sector

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OPINION

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The obituary for defined-benefit pension plans in the private sector was written long ago. Now we can add a date to it.

Defined-benefit pension plans – or DB plans, as they are known in the industry – are the plan of choice for unions and, indeed, most employees, since they provide a predictable amount of pension at little or no risk to the individual. With a few exceptions, it is the plan sponsor who assumes all the risk. This is precisely why such plans are dying in the private sector; so few employers are still willing or able to stomach that much risk.

It is well known that DB plans have been in decline in the private sector since the 1990s but the extent of the decline is the subject of much unnecessary debate. Statistics Canada tracks plan membership on a year-to-year basis. This is shown in the chart for both the private and the public sectors.

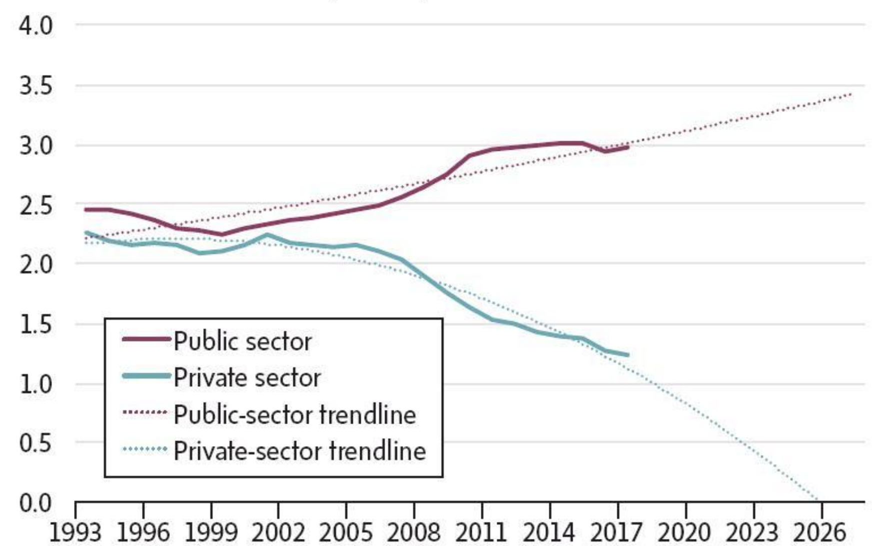
There have always been more DB members in the public sector, even though the private sector is four times as large. The real story though is that the end of the road for DB plans within the private sector now seems to be within shouting distance. The decline is now far enough along that the actual date of extinction can be predicted with some confidence.

I have taken the raw data represented by the solid lines in the chart and have attached a trendline to them. This trendline, which is represented by the broken lines, filters out the "noise." Even so, it still fits the raw data remarkably well. By extrapolating that trendline another few years, we can see that the number of active employees still covered by DB plans in the private sector drops to zero by 2026. The number of active DB members in the public sector is expected to continue to rise over the same period to about 3.5 million.

Will there actually be no active DB members in the private sector by 2026? More likely there will be a few holdouts in capital intensive industries in which labour costs are a little less important or in businesses that compete directly with the public sector for new hires. Also, employees who were grandfathered when DB plans were closed to new hires might still be around then. Still, it is a near certainty that there will be fewer than half a million active DB members remaining in the private sector by 2026. This translates into 3 per cent or less of the private sector work force.

DEATH OF PRIVATE-SECTOR DB PLANS IS IN SIGHT

Number of active members (millions)



THE GLOBE AND MAIL, SOURCE: STATISTICS CANADA; FREDERICK VETTESE

Can this downward trend be arrested or even reversed? That is highly unlikely given what has happened in the past 25 years. Plan sponsors have abandoned DB plans in both good times and bad. In fact, there are several reasons why the trend will accelerate if anything.

First, the financial risk faced by plan sponsors has not gone away. We have gone nine years now without a major stock market correction and the next one will result in painful pension deficits. This will shake out a number of surviving DB plans.

And let's not forget the looming enhancement to the Canada Pension Plan. It will be phased in over a six-year period starting Jan. 1, 2019. If history is any indicator, a bigger CPP will result in more plans being shut down. Participation in pension plans peaked in 1977, the first year that full CPP pensions became payable, and has been falling ever since.

Third, there is the tipping point argument. If only 3 per cent of all private-sector employees still enjoy DB pension coverage, their employers will naturally start to wonder whether they have got it wrong and may all head for the exits en masse.

Without DB plans in the private sector, retirees will have to rely even more heavily on savings from registered retirement savings plans and defined-contribution pension plans to generate retirement income. Studies show that retirees are ill-equipped to convert their capital accumulations into steady income that lasts a lifetime. Most tend to underspend out of fear of running out of money too soon. This has always been a problem, but it will become more acute now that more than 1,000 Canadians are turning 65 every day.

The solution does not involve trying to bring back DB plans in the private sector. That ship has sailed. It does involve embracing capital accumulation plans and giving retirees more support. Employers who sponsor group RRSPs or defined-contribution pension plans can do much more to help than they do now. Turning their retired employees over to financial advisers who are heavily conflicted is not the answer.

Governments, for their part, could also do more to educate Canadians who rely on savings for their retirement income security. What seems to be holding them back so far is a lack of empathy. Virtually every senior government official and politician who is in a position to help is amply protected by a DB pension plan.

Finally, retirees themselves can overcome some deeply held prejudices against strategies that will ensure their savings will last a lifetime – such as buying annuities with part of their savings to hedge their bets and deferring their CPP starting age until 70.

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