

FP COMMENT

Pensions: All is not well

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[Jack Mintz](#), [FP Comment](#), [Pension reform](#)

Counterpoint

By Stephen Donald

On April 13 Alberta Finance Minister Ted Morton said that Canada should consider an “incrementalist” approach to pension reform. He would give the private sector another 10 years to improve retirement options for Canadians before deciding on the need for a government-led solution such as a new national pension scheme. He said there is no urgent need for changes to the retirement system in Canada because it is “not broken” and it already works well for many people.

Canada’s Finance Minister Jim Flaherty has also said there is no need to rush. “It has to be dealt with carefully, judiciously and deliberately. We can’t do this on the back of an envelope. One can do harm to what is a sound system. We need to cover all the issues and don’t unintentionally cause detriment to the current system.”

One of the chief sources of this “all is well” view is the December 18, 2009 Jack Mintz report Summary Report on Retirement Income Adequacy Research prepared after the first ministers’ conference in May. So far there has been little discussion or critique of his report, to my knowledge. I suggest the politicians have overly generalized his conclusions and the report should be reviewed by an independent researcher, given the impact it has had.

The Mintz report says 30% of Canadians are not saving enough for retirement at the 100% consumption replacement level; for some subgroups, that increases to 45%. It demonstrates that the subgroups of the general population who are not saving enough toward retirement tend to be modest and middle-income Canadians. Since civil servants enjoy relatively rich defined-benefit plans, it follows that the subgroup facing inadequate retirement incomes is the private-sector middle-income worker.

Pension reform needs to focus on this group and reasonably quickly — it takes 30 years for a retirement savings regime to mature unless special provisions are made. But Morton seems to have glossed over this fact. Flaherty, on the other hand, has made a few comments that indicate he is aware of this hole in the Canadian retirement system and that changes are needed, but not knee-jerk solutions.

In fact, the hole in the system may actually be large.

The report discusses ideal pre-tax income replacement levels and suggests the typical target of 70% may be too high. This is based on an OECD report that suggests 60% is adequate and, for those earning \$90,000, 50% may be adequate. But who in the \$90,000 income bracket would be happy with post-retirement income of \$45,000?

The Mintz report leans heavily on Keith Horner's Report for the Research Working Group on Retirement Income Adequacy in answering the question "are Canadians saving enough for retirement?" Horner uses a stylized model with very simplistic assumptions. It assumes people save for retirement from age 30 to 64, retire at 65, and live to age 84. It assumes that those who raise children need less income in retirement than those with no children. In Horner's words, "this reflects child-related spending and the assumption that the parent will seek to replace only 'own consumption' after retirement." His results indicate that for households earning \$80,000, for example, the couple without children needs to save 8% of earnings while the couple with children need save only 4%. The result is that those with children tend to show up in the report as financially well prepared for retirement — though in real life, they may find themselves a lot closer to the poverty line.

To answer whether Canadians are saving enough for retirement, you have to look at how much they are actually saving and compare it to the developed target rate. For members of a registered retirement plan, Horner assumes their reported pension adjustment is equal to the actual contributions made on their behalf. If actual contributions are overstated, then the report underestimates the number of Canadians not saving adequate amounts. One factor omitted from the analysis was the impact of civil servants' pensions on the results. Because of their relatively rich pension plans, they tend to bring the "adequate" averages up. Conversely, one can probably assume that the averages for the private sector are lower than those shown in the report. This will be further exacerbated in the future by the continual decline in private-sector pension coverage.

While I am not saying these assumptions are wrong, I am saying they need further scrutiny and the public and the policymakers need to know the underlying assumptions. The Mintz report, despite the politicians' conclusions that all is well, does indicate that the middle-income private sector is falling far short of adequate retirement savings. An independent review of his report is necessary to see if that hole in the system is not larger than he indicates.

Pension reform should focus on the modest and middle-income private-sector worker. A "go slow" approach will not work. There is enough tax-assisted room in the current

system for this group but they need a nudge of some sort to use it. It is the job of pension reform to somehow provide that nudge.

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