# DEFINED BENEFIT PENSION PLANS: STRENGTHENING THE CANADIAN ECONOMY

## Canada's defined benefit pension plans: a snapshot

Defined benefit ("DB") pension plans are a cornerstone of Canada's economy. In each of 2011 and 2012 (the most recent years in which data is available) these plans collected between $44-47 billion in mandatory contributions from members and employers, and paid out between $68-72 billion in benefits.

Figures provided by four major Ontario pension plans show that the vast majority (up to 80 cents) of each pension dollar paid out comes through investment returns, which in turn come from sound funding policies and "best in class" investment results at home and abroad.

Defined benefit pension plan members tend to be **more financially secure** than non-members. An estimated 10-15% of DB beneficiaries collect the Guaranteed Income Supplement (GIS), a supplemental payment to the Old Age Security (OAS) pension that is provided by the Government to low-income seniors living in Canada. This compares with an average of between 45-50% of other retirees who collect GIS. DB pensions reduce the annual GIS payout by approximately $2-3 billion annually.

The largest of Canada's DB pension funds are a success story on the world stage. Active investors in real estate, infrastructure and private equity, their solid performance and well-developed governance structures have helped establish Canada as a centre of excellence in institutional investing. Aided by well-developed governance structures that allow them to operate in the best interests of members with little or no outside interference, they have helped provide stability and solid returns to the funds and plan members during a highly volatile period for capital markets.

## Who belongs, who benefits

**Stable membership**

DB pension plans have about 4.5 million members and 3.5 million beneficiaries across Canada. Total membership has remained stable over the past decade; however, it has declined as a percentage of the total population.

**Quebec leads in DB membership**

31% of all employees who are members of DB pension plans reside in Quebec, giving the province the highest proportion of members in Canada. By contrast, Ontario has 24%, British Columbia 22% and Alberta 20% – the smallest proportion among the provinces. Overall, the distribution of plan members across the country mirrors the population, with the majority of members in Ontario and Quebec.

**Small towns, big benefits**

The smaller the community, the larger is the impact of pension benefits on the local economy. For small towns like Moose Jaw, Nanaimo and Orillia, DB pensions form on average 9% of the total earnings in these communities. For large metropolitan areas like Toronto, Vancouver and Montreal, the average is 6%; for mid-sized towns like Ottawa, Halifax and Quebec City, it is 8%. For small Ontario towns, the percentage of total earnings constituted by DB pension benefits was 11.5% vs. an average of 7% for the province's entire earnings population.

When combined with the CPP, OAS and individual RRSPs, DB pension earnings constitute about 18% of all earnings in small towns. This is particularly important to the economies of smaller communities, particularly those whose populations are demographically skewed towards older Canadians and whose local economies benefit from their expenditures on goods and services.

## Benefits reinvested into the economy

The benefits paid out to DB pension plan members ultimately flow back into the Canadian economy in the form of consumer spending and taxes, generating business growth and employment, and generating revenues for all levels of government. Using the reference years 2011 and 2012, it is estimated that beneficiaries spend $56-63 billion annually on consumable goods, shelter, durable goods, recreation, services, and sales and property taxes. They pay an additional $7-9 billion in income taxes, while a further $2-3 billion flows back into their savings. Payouts of DB plan benefits to members are reinvested in the Canadian economy through various channels.

Annual spending by DB plan beneficiaries on durable and consumable goods is estimated at $56-63 billion and is widespread across the economic spectrum.

Canada's senior population continues to be a significant source of revenue for all levels of government throughout their retirement years. For those who are the beneficiaries of DB pension plans, total taxes paid are estimated at $14-16 billion annually. The breakdown is about $7-9 billion in income tax, $4 billion in sales tax and $3 billion in property tax.

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| **Consumables:** | $15-16 billion | food & beverage, clothing, medicine, personal care, sales tax, etc. |
| **Shelter:** | $14-15 billion | rent, utilities, mortgage, home insurance, property & sales tax, etc. |
| **Durables:** | $10-11 billion | auto purchase & ongoing expenditures, household furnishings & large appliances, household services, sales taxes, etc. |
| **Recreation:** | $11-12 billion | hotels & restaurants, gifts, entertainment, charity, taxes, etc. |
| **Services:** | $9-10 billion | personal insurance, communication, health services & insurance, financial & legal services, taxes, etc. |
| **Taxes:** | $14-16 billion | $7-9 billion in income tax, $4 billion in sales tax and $3 billion in property tax. |

Prior to retirement, wage earners who are contributing to a DB plan benefit by having their taxes reduced (or deferred until after retirement, when their income and tax rate is typically lower than during their working years). This too has a salutary effect on the economy by putting more disposable income into the hands of consumers.[1]

Based on 2011/2012 data, it is estimated that DB contributions reduce/defer the income taxes of member contributors annually by $5-7 billion, sales tax by $3 billion and property tax by $1 billion.

[1] While government tax revenues are thereby reduced, this is more than compensated for by the fact that future retirees are more financially independent, thereby lessening their need for government assistance. Indeed, an aging and dependent population is one of the greatest challenges faced by national governments around the world

## Strong fund returns ensure pension promise is kept

The vast majority – up to 80 cents of every dollar, according to an analysis by four major Ontario pension plans – of pension benefits paid out by DB pension plans can be attributed to investment returns. The rest of that pension dollar comes from member contributions, which are usually matched by their employer. Beneficiaries make contributions to their plans throughout their careers, and those contributions are invested by some of the world's top investors. An earlier study by the Boston Consulting Group found that, at the end of 2011, more than 35 per cent of the retirement assets in Canada, then totaling upwards of $714 billion, were directly invested by Canada's Top 10 public pension plans.

## A closer look at Ontario

**~$30 billion in pension payouts**

Defined benefit pension plans in Ontario pay out about $29-31 billion – or roughly 80% more than they take in. The payout flows back into the provincial economy as follows: $7 billion on consumables, $6 billion on shelter, $5 billion on durables, $5 billion on recreation, $4 billion on services, $3 billion in income tax and $1 billion in savings.

**$6 billion in taxes**

DB payouts to Ontario beneficiaries generate an estimated $3 billion in federal and provincial income tax, $2 billion in federal and provincial sales tax and $1 billion in property tax on an annual basis.

**Economic boost to Ontario**

What would the impact be on Ontario's economy if there were no DB pension plans? Using the same spending categories as the national comparison above, it is estimated DB plan payouts increase consumables spending by 75% or $3 billion, shelter by 100% ($3 billion), durables by 66% ($2 billion), recreation by 150% ($3 billion) and services by 300% ($3 billion).

## SOME CLOSING THOUGHTS

The numbers above tell a compelling story about the very positive impact of DB pension plans on the Canadian economy. Contributions by beneficiaries, matched by their employers, are invested over time, resulting in annual payouts of $68 to $72 billion per year in Canada, with approximately $30 billion of that paid out to Ontario retirees. This impact then flows through to the economy via markedly increased spending by retired beneficiaries on a wide range of goods and services.

Retirees in small towns in Canada rely more heavily on DB pension plan payouts as part of their overall retirement income than those in mid-sized towns and cities or in large metropolitan areas. Given that the economies of smaller communities are enhanced by spending on goods and services by their retirees, it is clear that DB pension plan payouts are a key contributor to Canada's small towns.

None of these benefits would be possible without the asset management expertise housed among Canada's DB pension plans. Through their investment of members' contributions in public and private markets in Canada and around the world, they are creating long-term value for their 8 million members and beneficiaries, contributing to economic growth through increased purchasing power by retired plan members, strengthening the economies of small towns and reducing the pension payout burden on the federal government.

Canada's DB pension plans make an important and multigenerational contribution to Canada's prosperity.

***Disclaimer:*** *Information in this document is sourced from a Study conducted by The Boston Consulting Group (BCG) and commissioned by Healthcare of Ontario Pension Plan (HOOPP), Ontario Municipal Employees Retirement System (OMERS), OPSEU Pension Trust (OPTrust) and Ontario Teachers' Pension Plan (OTPP). The materials excerpted by commissioners from the Study referenced are provided for discussion purposes only and may not be relied on as a stand-alone document. Additional analysis has been done to the data and analysis contained within the Study by third parties other than BCG. BCG has not independently verified this additional analysis and assumes no responsibility or liability for it.*