Who(se) Benefits?

McMaster University Faculty Association
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McMaster's Administration has a plan for dealing with future pension and post-retirement health and dental benefit obligations. They have announced that they intend to close the defined benefit (DB) pension plan to all new employees and remove their eligibility for post-retirement health and dental benefits. The defined benefit plan will be replaced by a group RRSP.

Already a few of the hourly employee groups have agreed to these new arrangements. More recently this plan has been imposed on future members of The Management Group (TMG) which has no meaningful voice in such decisions. Furthermore the President and Vice-Presidents, who themselves have extremely generous pensions and post-retirement benefits, have decided that *future* Presidents and Vice-Presidents will no longer be eligible for DB pensions or post-retirement health and dental benefits. However, it is likely that future Presidents and Vice-Presidents will negotiate contract terms that will fund retirement expectations higher than would be available under current DB pension and post-retirement benefit plans.

By reducing benefits only for new employees, the Administration hopes to gain acceptance, since no one involved in making the decision will be affected personally. However the change will create two classes of employees, an ever-growing group of new employees with inferior benefits and a shrinking group of continuing employees with the current benefits. If MUFA agreed to such a two-tier system, it would be condoning the creation of a significant, long-lasting inequity among its members and opening itself to conflicting objectives in future remuneration negotiations.

What is driving this plan? The Administration and some Board members claim that large pension deficits created by the current market downturn will require crippling deficit payments and furthermore that the accumulated liability of post-retirement benefits will increase enormously, devastating the University's financial position. This is a familiar story for companies in the US where, in the absence of universal health coverage, post-retirement benefits are extremely expensive and where pension plans have been mismanaged and misused to the point that bankruptcy is often the only solution.

Although it is obvious that ending post-retirement health and dental coverage will be disadvantageous to future retirees, more thought is required to understand the implications of changing the pension benefit. Traditional DB pensions have become unpopular with employers who currently shoulder all of the investment and longevity risk. For most of the past two decades, pension funds with adequate contributions have been in surplus. The recent market crash, however, turned surpluses into deficits which may ultimately require large extra payments. The responsibility for deficit payments to a DB plan lies completely with the employer, although in practice the burden is shared by employees through higher contributions.

To avoid the responsibility of pension deficits, many employers prefer Defined Contribution (DC) plans. A group RRSP is a kind of DC plan, although it is actually a savings plan rather than a pension. Compared to formal DC pension plans, a group RRSP is lightly regulated and lacking in transparency. In particular, employer contribution rates may be different for different groups, and can easily be changed.

What happens to DC plans when markets crash? In this case the consequences rest entirely with the employees. Employees who have just retired and started to spend from their DC savings are in serious trouble, and thousands of retirees who thought that they had adequate savings begin to wonder if they have to return to work. On the other hand, employees who were close to retirement now find that they cannot afford to retire, which has consequences for them and for their employer who had expected them to retire.

Perhaps the worst flaw of DC plans is that investment risk falls unequally on different generations of employees, depending on prevailing conditions at the time they retire. If markets are strong then savings will be substantial and retirees are more or less guaranteed (or they can afford to buy annuity products to ensure) that they will not outlive their money. On the other hand if markets have collapsed close to retirement, there is no escape. The risk of running out of money is substantial. Add to this the continuing cost of health and dental coverage, no longer provided by the employer, and the picture becomes truly frightening. It is this scenario that the Administration is proposing for all future employees at McMaster.

DB and DC pensions are polar opposites, each characterized by asymmetric risk borne by different groups. However, it is important to realize that there are other options. There are, for example, target benefit plans which have defined contributions for the employer and defined benefits for employees (such as the UBC Staff Pension Plan). Instead of doing the hard work required to create a better plan, the Administration is cutting corners in an attempt to save costs, following in the footsteps of a herd of other institutions and companies. As is typical for such herd-like behaviour, the resulting financial benefits are likely to be disappointing, particularly in this case where it is the current pension deficit which promises to be onerous — not the cost of new employees. Making deficit payments on the existing plan may indeed be problematic and compete with other important needs of the University. This problem will not be mitigated by closing the DB pension plan, which amounts to closing the barn door after the horse has run away.

Rather than closing the present pension plan and putting new employees into a group RRSP, McMaster's Administration and its employees should take the time and make the effort to design and implement an improved pension plan, which shares risks fairly across all groups and across generations, as is fitting for a public institution such as McMaster, while providing a competitive benefit package to recruit and retain outstanding faculty and staff. Furthermore, it would be prudent to wait for the recently constituted Federal-Provincial Task Force on Pension Reform to issue its report later this year on whether Canada's pensions laws need an update.

Instead of creating divisions among employees along generational lines which will be a source of future discord, all members of the University should work together to design a retirement plan which is attractive enough that those who are affected will approve it.

For current information about pension plan issues in Ontario, see the Report of the Ontario Expert Committee on Pensions, *A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules*, at http://www.pensionreview.on.ca/english/report/Pensions_Report_Eng_web.pdf