LESSONS FROM DENMARK

The Danish can teach Canadians a thing or two about pensions

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Quick word association game: Denmark. What’s the first thing that comes to mind? Pastries? LEGO? Beer? Now, add pensions to the list.

Denmark apparently has the world’s best pension system. It ranked No. 1 (out of the 20 countries assessed) in the 2013 edition of the Melbourne Mercer Global Pension Index, produced by Mercer and the Australian Centre for Financial Studies. Canada’s pension system ranked No. 6 for the second consecutive year.

While Canada was judged to have a good retirement system, the report highlighted two well-documented problems: low workplace plan coverage in the private sector and low household saving rates. These findings are consistent with a 2013 study by the Organisation for Economic Co-operation and Development (OECD). The OECD figures show that the poverty rate among Canada’s seniors—while much lower than that of the general population—has climbed to 7.2% for the past two years. So what can we learn from Denmark?

The Right Components

Like Canada, the Danish system consists of social security, workplace plans and personal savings. But the biggest difference relates to occupational plans: Danish law requires employers to provide pension plans and employees to enrol in them. Canada has a voluntary system, in which only a quarter of private-sector employees participate.

As a result, according to the OECD, a typical median-wage Canadian can expect a gross income replacement rate of 45.4% (excluding voluntary savings), compared with 78.5% for his or her Danish counterpart. At 150% of the median wage, the difference is even starker: 50.2% in Canada versus 64.4% in Denmark.

This is clearly a weak link in Canada’s retirement system, creating a bifurcation in the future retirement security of working Canadians. The minority who participate in occupational plans will likely enjoy a decent retirement, while the majority who don’t will face an uncertain future.

New Solutions

The most direct solution is to mandate employer-sponsored plans. While accepted in many other countries, this idea would likely be met with vigorous opposition in Canada, particularly from small businesses concerned about the additional costs. A more likely—but far less effective—approach would be to create new incentives for private-sector employers to offer pension coverage. To make a real difference, employers would need to have easy access to pooled plans run by a third party (including pooled registered retirement plans and pooled target benefit plans).

While this might help, it’s wishful thinking to expect major improvements in retirement income security to come entirely from increased employer plan coverage in a voluntary system. The solution is also unlikely to come from higher voluntary personal retirement savings. Canada’s tax system encourages retirement savings, yet the country has over $600 billion of unused RRSP room.

The most effective solution may be to enhance our social security plans. The OECD report shows that Canadian seniors receive only 39% of their income from social security systems—far below the OECD average of 59%.

The Canadian system relies heavily on employer plans and individual savings—both of which are proving to be less dependable. The current proposals to expand the Canada Pension Plan in a modest, gradual and financially responsible manner—targeting middle-income earners—may be the best way for us to learn from the Danish. Canada can then get the same result as Denmark by following a different path.

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