

Research Project #12: Alternative Governance Models

Research Paper: Vehicles for Collective Provision of Pension Services: Pension Plans for Small and Medium-Sized Enterprises

Researcher: Teresa Ghilarducci

Date: 2007

Executive Summary

This study is part of the Ontario Expert Commission on Pensions (OECPC) consultation on the occupational pension system in Ontario. The OECPC's primary focus is on defined benefit plans. The Commission aims to describe the various factors leading to the decline in pensions and to explore issues relevant to "the security, viability and sustainability of the pension system in Ontario."

This study examines how the size and organization of defined benefit pension plans affects their function and structure. The size of the employer often determines the size of a pension plan, but it doesn't have to. Therefore, this study pays special attention to the issue of "pooling" and describes the characteristics of a well-run employer defined benefit pension plan.

The data used, and the literature reviewed, focus on the U.S. experience with multiemployer plans in the private sector and the public sector (government plans such as for state and municipal employees) and, to a lesser extent, the experience in the Netherlands and Sweden.

The study concludes that smaller employers can provide better pensions when they can attach their pension plans to a larger entity to take advantage of economies of scale in administration and in risk control that leads to greater bargaining power, and superior coordination of benefits and employment.

In fulfillment of the research mandate several voluntary employer-based defined benefit plan systems are described. Only in special circumstances – in union environments and in the government and not-for-profit sectors – do workers in small and medium – sized firms and those workers who have low incomes, obtain pension coverage under a second-pillar employer pension.

The study:

1. reviews the literature on ideal pension design with emphasis on the consensus and points of disagreement among scholars;
2. Reviews the literature on multiemployer structures, specifically the U.S. experience with voluntary multiemployer plans in the private and public sectors and the Netherlands and Sweden. Small establishments who want to sponsor defined benefit pensions have been created in these jurisdictions.
3. Given the paucity of academic research in the area I report, briefly, on a multivariable regression analysis that examines how the size of a pension plan and the structure of the pension board affect the benefit formula (the pension generosity) and the funded status of the plan, using a sample of 163 U.S. public sector pension plans. There are some effects: underfunded plans and larger plans have slightly larger benefits. Governance structure has no effect on benefit structure or unfunded status.
4. Academic work on optimal pension design and descriptions of international and domestic pooled pension funds outline the challenges faced by small establishments in providing efficient and effective pension systems. Small groups of employees have pension plans when large plans take part in administrative agreements with small groups.
5. Often these administrative agreements form hybrids between a defined contribution and defined benefit pension. The contribution to an account comes from work and the proceeds are distributed at retirement in the form of a mandatory annuity.