A Different Kind of Registered Pension Plan

Financial wellness. Retirement preparedness. Whatever you call it; Canadians face greater responsibility for their own financial security in retirement as fewer people will receive guaranteed lifetime income from traditional Defined Benefit pension (DB) plans.

There are plenty of surveys confirming that Canadians are concerned about retirement. In September 2019, the Canadian Payroll Association reported that 43% of Canadians said financial stress is affecting their workplace performance, and 70% said they have only saved a quarter or less of what they feel they will need to retire.

In recent analysis done by Morneau Shepell, it shows that financial well-being is a strong predictor of short-term disability. Furthermore, employees who must manage their retirement investments In a Defined Contribution (DC) Plan or RRSP are more likely to have additional stress that affects their work due to lack of investment knowledge and potentially higher management fees

What Are the Options?

The classic DB plan is a retirement arrangement whereby an employee receives a set monthly amount upon retirement, guaranteed for the life of the recipient and spouse/partner. The amount of monthly pension is a function of the participant's years of service, percentage of employment earnings or a flat dollar amount, and age at retirement. In some cases, the pension is adjusted for inflation as well.

A DC plan is a retirement savings program under which the employer and employee make contributions to a participant's pension account during employment. Instead of a set monthly amount upon retirement, the goal of a DC plan is to accumulate as much money as possible through contributions and investment earnings by the time a participant retires. The participant then must decide how to spread that money across their retirement years.

Although DB and DC pension models have advantages and disadvantages, neither provides an ideal answer to a workplace pension. The general criticism of DB plans is that employers cannot handle the fluctuating cost and risk of DB plans that rely on interest rate levels and stock and bond market returns. The criticism of DC plans is that the employee takes on all the investment risk and risk of outliving their savings. Instead of the DB and DC pension models, the authors of a C.D. Howe commentary, Robert L. Brown and Stephan A. Eadie, presented a shared-risk solution of large, collective, pooled pension plans governed by an independent management board.

Collective, Pooled Pension Plans Are Trending

What Brown and Eadie proposed has become more viable by the Ontario government as well as the Nova Scotia government and is generating interest across the country. Examples of such plans include:

- The Colleges of Applied Arts and Technology (CAAT) Pension Plan introduced a new pension design called DBplus in June 2018. It provides a DB plan based on fixed contributions of 5% to 9%, which is set upon joining, for members matched by the employers. DBplus is available to organizations from the private, public and not-for-profit sectors. It can accommodate employers of various sizes with a DB, DC or group RRSP or no plan at all. DBplus provides a lifetime pension with conditional inflation protection and a survivor benefit. The inflation protection is based on the annual increase in the Consumer Price Index and is conditional on the funded status of the plan. To date, there have been nine employers who have joined the CAAT Plan, including the Royal Ontario Museum (ROM), Torstar Corporation and SHARE (Shareholder Association for Research and Education).

- OPSEU Pension Trust introduced OPTrust Select, also in 2018. It's a defined benefit pension plan aimed at the not-for-profit sector. Members contribute 3% of earnings and employers match the contributions, with an annual pension accrual rate of 0.6% of earnings. OPTrust provides a lifetime pension to members with earnings upgrades and cost of living increases dependent on the OPTrust Plan's funded status and annual Board approval. OPTrust Select announced seven employers joined with a total of 215 members in April 2019.

- Nova Scotia Public Service Superannuation Act modernized in 2012 and the Public Service Superannuation Plan (PSSP) has been amended to allow universities, municipalities, agencies, boards and commissions to join.

- SEAMARK Asset Management has tackled the issue by creating an online Group RRSP within which SEAMARK takes on the fiduciary duty of delivering an outcome based on the contributor's unique circumstances. The pension payment is not defined but the stress of figuring out how to achieve a reasonable level pension amount is migrated from the employee to the fiduciary.

These are examples of innovation occurring in the Canadian pension sector aimed at helping provide individuals with a more secure DB-style pension while helping relieve employers of the risk and administrative burden.

The Value of a Good Pension

Plans such as Ontario Teachers', OMERS, Healthcare of Ontario Pension Plan (HOOPP), OPSEU Pension Trust, CAAT Pension Plan and the NS PSSP are more efficient at providing lifetime retirement income than most DC plans and group RRSPs because they pool investment and longevity risks across so many participants. These plans are jointly governed, meaning they have representation by both members and employers on their boards. Further, they are very large plans, independently administered, with low operating expenses. This means a higher proportion of contributions go toward funding valuable pension benefits rather than overhead costs.

Such plans improve financial wellness by delivering secure lifetime retirement income and by sparing members from the stress of making investment decisions, deciding how to time their retirement to market cycles and deciding how to withdraw their savings in retirement to make it last a lifetime.

Employees with DB plans are more confident about retiring with a secure pension. With greater confidence in their ability to meet their retirement income needs, DB-type plans can also improve employee retention, thus helping to reduce recruitment and training costs. A DB-type plan may also minimize costly severance payments or unproductive "presenteeism" by employees that put off retirement out of fear that their retirement income will be inadequate.

Conclusion

Recent innovations in pension plan design, such as those described above, offer significant benefits to both employees and employers. It behooves both groups to familiarize themselves with these plans and to assess whether they are a good fit for their companies.

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