

While the pension debate continues with some interesting ideas for the future, the finish line still seems far off and the path uncertain.

On the one hand, we have those who feel that the future viability of traditional Defined Benefit plans is merely a stock market rally and/or increased bond yield environment away. Others are ready to move forward with fixed employer contribution pension plans – Defined Contribution and Target Benefit pension plans. And somewhere in the middle, there is a very small group of people quietly wondering why jointly-sponsored pension plans aren't getting more air time.

But let's back up a few steps. Much of the concern about the current state of pensions started with the acknowledgement that the number of DB pension plans was decreasing. People began to realize the effect that the potential bankruptcies of a few high profile companies would have on thousands of Canadians and their 'guaranteed' pension income.

'Pension Coverage'

Then the discussion shifted more towards 'pension coverage' – more specifically, the number of

ber, and make it affordable for both the employer and member, then we have addressed the biggest problem. We would then be in a much stronger position to tackle how to get more employers and workers involved in occupational pension plans – that is, increasing pension coverage.

The debate should be less about DB versus DC and more about:

- ◆ How much to contribute (employer and plan member) each year for a given starting age and expected retirement age
- ◆ How to maximize the monthly pension that a dollar contributed today should realistically be able to produce at retirement
- ◆ How to minimize the risk of the expected pension income ending up much smaller than needed
- ◆ What systems and controls are needed to mitigate the risk of individual plan members and plan sponsors taking actions that run counter to the purpose of the plan

Let's start with the DC plan that has, so far, been lacking for many working Canadians in the private sector.

With the average employee expected to bear all financial risks associated with his or her retirement



DC PENSIONS

By: Kevin Sorhaitz

Dynamic DC: A Real-world Solution

Canadians that do not have access to an occupational pension plan and the strain that will eventually put on the government.

And during all of this, we spent a fair amount of time discussing the 'pension income adequacy' of DC plans, and the financial literacy of plan members who are bearing the risks and decisions that are big part of these plans.

The debate seems to be back to which is the better design, DB or DC. But regardless of the retirement savings or pension vehicle, what's really at stake is whether the plan will provide adequate pension income in retirement.

I would suggest that if we start with pension income adequacy for the 30-something plan mem-

bers, is it realistic to expect everyone to become financially literate? Most of us don't want to learn all the complex details of how to fix our own car; similarly, the average Canadian needs someone else to take care of most of the financial decisions required as part of a retirement savings program.

'Accidental Pension'

Pension income adequacy, or a targeted amount of retirement income, is a function of the number of years of plan participation, the amount of contributions made each year, operating expenses, investment returns, and bond yields at retirement, plus the number of years the pension will be paid (a.k.a. longevity risk). It's no wonder that the traditional DC plan

DYNAMIC DC			
Requirement	Yes	No	Possible
Employee contribution of five percent of base pay	✓		
Profit-sharing component			✓
Member contribution based on targets that auto-escalate with age	✓		
Outsourced investment	✓		
Annuity markets feature	✓		
Pension committee management	✓		
Safe harbours	✓		

with do-it-yourself (DIY) investing has been referred to as an 'accidental pension.'

While DC has fixed a lot of problems for employers, it isn't been nearly as effective in helping plan members generate an adequate level of retirement income. The current DC retirement savings model, which has employer contributions of less than five per cent, member contributions of less than three per cent, and members making fund selections, is woefully inadequate to be seriously considered a DB replacement.

While a good plan design and a well-considered investment fund line-up can improve the outcome for DC, it doesn't go far enough to address all of the inherent shortcomings of the DIY approach.

There has been much talk about improving the DC plan platform, developing innovative solutions, learning from our global counterparts, and the like. We are at the tipping point of a DC transformation. There is an opportunity for all stakeholders – government, plan sponsors, plan members, service providers, and consultants – to take action and fix what we all know is broken.

Dynamic DC

The dynamic DC, the enhanced DC plans of the future, will be able to accomplish the top priorities for any retirement savings program. It will provide a pre-set target retirement income, a replacement ratio of 60 per cent to 80 per cent for people earning \$50,000 to \$100,000, with government pensions included in the analysis. It calls for an employer contribution of at least five per cent of base pay, with a possible profit-sharing component. Member contributions will be based on targets that auto-escalate with age. Investment decisions will be outsourced as in DB plans, eliminating the need for plan members to manage assets, by hiring a fiduciary investment manager; and the asset mix for any individual will be based on his or her age and risk profile. It will have features that take advantage of favourable

What Is a *Dynamic* DC Plan?

It's an enhanced version of a traditional DC plan that systematically incorporates features and controls to help manage and maximize retirement saving 'outcomes.' Dynamic DC plans allow the average employee to have a retirement savings plan that can run essentially on auto-pilot without requiring them to become investment experts. At the same time, it eliminates most liability issues for employers and provides a framework for proper plan governance and regulatory compliance.

annuity markets along the way. It will be managed by a pension committee with member representation to monitor individual plan member performance towards target benefit and provide education that focuses on saving. It will provide 'safe harbour' rules that protect employers from legal liability risk if they adopt a specified governance, risk management, and compliance system to run and oversee the pension program.

As we search for solutions for both employers and employees, it is our industry's responsibility to develop an easy to

implement and pragmatic solution that meets the needs of employers and workers. If we can fix the DC pension plan first to provide adequate pension income then we can move on to other retirement savings vehicles and ultimately to tackle the pension coverage issue in Canada. ■

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