Today’s Objectives

- To discuss types of combination pension plans

- To discuss terms and conditions of pension plans

Recall that:

C. Combination of DB and DC Plans

- Combination plans include:
  i. Hybrid Plans
  ii. Combination Plans
  iii. Cash Balance Plans
  iv. Multi-Employer Plans
  v. Target Benefit Plans

i. Hybrid Plans

- **Most common hybrid plan type will provide the greater of {a defined benefit pension, the pension that can be purchased with a members DC account balance}**

1. <u>Registered Pension Plans (RPPs)</u>

Types of Registered Pension Plans (RPPs)

C. Combination of DB and DC Plans

ii. Combination Plans

- Pension benefit is the sum of pension provided through the DB component and pension provided through DC component

Example:

- DB: 1% of final average earnings (FAE) (non-contributory plan)
- DC: e’ee contributes 3-5% of salary to a DC plan
- At retirement, e’ee gets annual pension benefit = (.01)(FAE)(yos) PLUS they can use the DC account value to purchase additional annual retirement income

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Note:

- Hybrid Plans and Combination plans aggregated account for a very small % of RPPs in Canada (less than 2%)
- Reasons for this are that these plans are very complex to administer and difficult to explain to plan members
- Simpler alternative to previous example: DB (as given) + Group RRSP!

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iii. Cash Balance Plans

- **These plans are more popular in the USA then Canada** (some issues with ITA in Canada)
- Here’s how they work:
  - E’ees are assigned annual credits based on earnings during year
  - Credits deposited into a ‘hypothetical’ account for each e’ee
  - They accumulate with interest until retirement/termination
  - The employer (e’er) makes the investment decision and takes the investment risk and is liable for a minimum guaranteed benefit

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iii. Cash Balance Plans

- Advantage:
  - These plans tend to provide a much higher benefit upon termination (e.g. hypothetical account value vs. a DB commuted value of benefits) than regular DB plans, which appeals to some employees

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   iv. Multi-Employer Plans (MEP)

- Established by union negotiation with two or more non-affiliated employers (e'ers) in a related industry
- Plans specify both the contribution level & level of benefits
- All employers (that are part of MEP) contribute to the plan
- Benefits typically determined using a flat benefit formula
- **Unlike single employer plans, benefits may be reduced if they cannot be supported by current level of contributions and/or employers are unwilling to increase contributions**

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  v. Target Benefit Plans

   - Similar to design of multi-employer plans, but they are established by a single employer
   - Designed to deliver a targeted benefit but administrators can adjust benefits (reduce if funding issues)
   - Provinces at varying stages with these plans (as of 2016 available in 4 provinces)

1. <u>Registered Pension Plans (RPPs)</u>

Terms and Conditions of Pension Plans

- A pension plan is a legal promise and principal provisions relate to:
    1. Eligibility
    2. Pension formula
    3. Credited or pensionable service
    4. Employee contributions
    5. Retirement Age
    6. “Normal” and Optional Pension Forms
    7. Pre-retirement Death Benefits
    8. Termination Benefits
    9. Disability Benefits
    10. Inflation Protection

1. <u>Registered Pension Plans (RPPs)</u>

Terms and Conditions of Pension Plans

1. Eligibility
   – When an employer (e'er) offers an RPP, all employees (e'ees) within a similar class (for whom plan was established) must be eligible to join the plan
   – Most provinces require e'ees be eligible within 2 years of employment (maximum) but many require less time and some companies allow membership on employment start date
   – Part-time** e'ees are eligible for plan membership if in same class as full time e'ees (that are covered by a plan)
   – Larger employers may have more than one plan (e.g. separate one for union, salaried, execs)

** Difference between part-time and contract

1. Registered Pension Plans (RPPs)

Terms and Conditions of Pension Plans

2. Pension Formula
   - Defines how pension benefits are credited/accumulated
   - Formula varies by plan type.
     - DC - contributions amounts, investment options
     - DB - flat benefit, career average, final average etc….
   - Defined Benefit pension formula may be integrated with C/QPP benefits {70% of pre-retirement income (pension + gov't plans) was a popular target for long service employees}

3. Credited or Pensionable Service
   - Defines period of service for which e'ee will earn pension benefits (e.g. maternity leave must be included by law)

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4. Employee Contributions
   - In Canada
     - most union plans are non-contributory
     - about half of private sector plans are contributory
     - all public plans are contributory
   - Contributory plans more common in Canada (tax deductibility) versus the United States
   - E'ee contributions (contributory plans) range from 5-7% in private sector plans and higher 7-9% in public sector plans
   - E'ees can make additional optional contributions - more popular with DC plans

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Terms and Conditions of Pension Plans

4. Employee Contributions (continued)
   – 50% rule - this is for contributory DB plans (**e'ers must fund at least 50% of the value of a plan member's benefits**) → if not, excess is returned to ee

5. Retirement Age
   – **<u>Normal Retirement Age (NRA)</u>**
     • NRA is the age specified in the RPP contract at which the e'ee has the right to retire on a full unreduced pension
     • For most plans, the NRA age is 65
     • Employees can, and often do, retire before the NRA – **with or without a pension reduction**

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5. Retirement Age (continued)

– <u>**Early retirement**</u>
  - Legislation allows an unreduced pension to be paid as early as age 60 or when years of service (YOS) is 30 or when age + YOS = 80
  - Otherwise, person retiring before NRA receives a reduced pension
  - Plans ordinarily allow e'ee to retire anytime within 10 years of NRA but with a reduced pension (unreduced pensions not always offered)

– Reduced pension on early retirement calculated in one of 2 ways:

  i. An actuarial equivalent reduction

  ii. A reduction that is less than the full actuarial adjustment

Example – Retirement Age

- Suppose that at NRA = 65, an individual's monthly RPP benefit is $4000 (or 48,000 annual pension).
- If the reduction factor is 6% for each year of early retirement, what would your RRP benefit be if you retired at:
  a) Age 63.5 years?
  b) Age 61 years?

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6. “Normal” and Optional Pension Forms
   - **“Normal” form** of pension is defined in every pension plan and this determines what benefits will be received when employee (plan member) dies after retirement
     - E.g. if ‘normal form’ is guaranteed pension (annuity) payments for 5 years and plan member dies 2 years after retirement, beneficiary would get 3 years of payments
     - **’Normal’ form often different for members who have a spouse** → joint & survivor (J&S) with reduced benefit (to 60%) on members death would be an example of a normal form for those with spouses/partners

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6. “Normal” and Optional Pension Forms (continued)
   - an “**Optional Form**” of pension can be elected before pension payments start and payment amount for the ‘optional’ form would be determined on an actuarial equivalent basis
     - E.g.: may choose a pension with a longer guarantee period, or a J&S with no reduction (where normal is 60% on death of member)

7. Pre-retirement Death Benefits
   - Legislation now requires these benefits
   - Pre-retirement benefits must be clearly defined in the plan document

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8. Termination Benefits
   - The benefits and rights of the e'ee upon termination of employment other than by death or retirement must be clearly defined in the plan document
   - E'ee always gets back his own contributions with interest
   - If e'ee is fully vested he/she can receive either
     - A deferred annuity
     - The commuted value of the deferred annuity, which then must transferred to a locked-in vehicle
   - More on this later

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9. Disability Benefits
   - A clear definition of disability for purposes of the plan is required
   - Most plans have some form of short term and/or long term disability coverage (definitions very detailed)

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10. Inflation Protection
    - There is no absolute requirement for inflation protection
    - Some plans have implicit protection – e.g. Final average earnings DB
    - With DC plans, as long as returns rise with or exceed inflation the e’ee is protected
    - For other plan types (DB - career average plan, flat benefit plan) only ‘protection’ is benefit enhancements/updates
    - But many plans have/do make ad hoc adjustments
    - Public sector plans often provide some form of inflation protection (e.g. indexed payments), details of which would be in their plan document