Today’s Objectives

- To discuss the economic problem of old age and ways to attack it

- To discuss Old Age Security (OAS)

Recall:

- The (*traditional*) **Three Pillars of Old Age Financial Security** (aka the three-legged stool)

Pillar I – Government Plans

Pillar II – Group or Employer (E’er) Plans

Pillar III – Individual Savings Plans

Group or Employer Plans

- The two types of employer plans we will look at are:

1. **Pension Plans (PPs)**
   - Pension plans are an employer benefit designed to help employees financially prepare for retirement
   - There are different types of PPs
   - Most PPs are **Registered Pension Plans (RPPs)** and that **will be our focus** (DB, DC, hybrids)
   - There are however non-registered plans and supplementary arrangements e.g. Supplemental Employer Retirement Plan (SERP)
2. **Group Registered Retirement Savings Plans (RRSP's)**
   - These are also intended to help employees financially prepare for retirement and have increased in popularity

1. Registered Pension Plans (RPPs)

Overview

- **RPPs are formally structured regulated plans**
  - Have to apply to Canada Revenue Agency (CRA) to register plan, under the ITA as well as provincial pension standards legislation
    - Income Tax Act (ITA): deductibility of contributions, tax sheltering
    - Respective provincial standards legislation (protects plan members) benefits for employees, rules for employers.
  - There are funding requirements (i.e., not pay-as-you-go)

    fully-funded.
- Employers (E'ers) are not required to offer RPPs for their employees (E'ees) and many do not

Module 2 – Old Age

→ Group or Employer Plans (Ch 1, 3, 9 and 14 of *Morneau Shepell Handbook*)

1. Registered Pension Plans (RPPs)

Overview

- Stats Canada numbers from 2014 show that
  - There are a total of 17,757 employer sponsored RPPs in Canada that cover 6.2 million employees (3.2 million public sector [government.], 3.0 million private [private business.]), and these plans have $1.6 trillion in assets
  - But **just under 40% of those working in Canada are members of an RPP**

- There is quite a difference between public and private sector both in terms of % of employees that are part of a RPP and also in RPP type

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

Overview

	Pension Coverage as % of # of e'ees	Total MV Assets ($ trillions)	Annual Contributions ($ billions)	Annual Benefits ($ billions)
Public Sector	86%	$1.1	$37.5	$36.5
Private Sector	24%	$0.5	$18.5	$24.6
Total	**38%**	**$1.6**	**$55.0**	**$61.1**
Public Sector Share	n/a	70%	68%	60%

Module 2 – Old Age
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1. Registered Pension Plans (RPPs)

Overview

- **Most (95%+) public sector employees with RPPs are members of Defined Benefit (DB) plans** that provide inflation (CPI) protection + other rich benefits, and tend to be contributory plans
- **Less than 50% of private sector employees with RPPs are members of Defined Benefit (DB) plans**
- Virtually no new Defined Benefit plans have been introduced in more than 10 years and several existing DB plans have been transitioned and/or replaced with another plan (or benefit, e.g. group RRSP)

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

Pension Plan Arguments

i. Government

Arguments for

- social utility
- reduce government pressure to increase income security benefits
- cash invested in the economy

Not strongly argued against, but

- tax relief granted does lead to loss of government tax revenue (timing issue only – pension payments when received are fully taxed)

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

Pension Plan Arguments

ii. Employers

Arguments for

- expensing of pension costs ('cost and order')
- contributions are a tax deductible expense
- help attract (recruit) and retain employees
- contributory plans (reduce employer costs)

to reduce the salary cost.

- retiring employees - ongoing and/or restructuring
- incentive (e.g. contribution tied to company's profits)

1. Registered Pension Plans (RPPs)

Pension Plan Arguments

ii. Employers

Arguments against

- could reinvest in own business ("higher return")
- admin. costs & complexities
- view of employer subsidizing government
- employee should assume responsibility for retirement - e.g. can provide higher salaries without the RPP (compensate more and offload risk to employees)
- other alternatives can be offered by employer (group RRSPs being one example)

1. Registered Pension Plans (RPPs)

Pension Plan Arguments

iii. Employees

Arguments for

- e'ees view RPP as essential leg of the 3-legged stool (or pillar)
- pension (Retirement Income) security
- tax sheltered savings
- convenience, discipline

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

Types of Registered Pension Plans (RPPs)

- There are 3 types:
  - A. Defined Contribution (DC) Plans
  - B. Defined Benefit (DB) Plans
  - C. Combination of DB and DC Plans

A. Defined Contribution (DC) Plans

- **37% of RPPs, 17% or RPP plan members are in DC plans**
- The plan can be considered 'contributory' or 'noncontributory' (same thinking applies to DB plans) - if it is only the employer that is making the contributions, it is a noncontributory plan, otherwise it is a contributory plan employer ?, 50%.

employer 100%

1. Registered Pension Plans (RPPs)

Types of Registered Pension Plans (RPPs)

A. Defined Contribution (DC) Plans
   - The amount of contributions to be made by the employer (e'er) is clearly defined and if it is a contributory plan, the employee (e'ee) contributions are also clearly defined
   - The contributions are invested and there typically are several investment options to choose from (employee chooses)
   - The contributions accumulate and the pension amount (or retirement income) is what accumulated contributions will buy
   - The pension income is therefore not known and not guaranteed – it will depend on investment returns, how many years of contributions are made, and when you retire

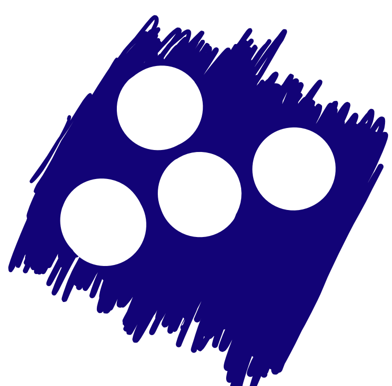
1. Registered Pension Plans (RPPs)

Types of Registered Pension Plans (RPPs)

A. Defined Contribution (DC) Plans

- **With DC plans, it is the employee who assumes 100% of the investment risk**

- There are two types of DC plans:
  i. **Money Purchase** - employer contribution is a fixed % of earnings
  ii. **Profit Sharing** - employer contributions linked to company profits subject to a minimum 1% of earnings



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

Types of Registered Pension Plans (RPPs)

B. Defined Benefit (DB) Plans
   - Plan member (employee or e'ee) is promised a "defined" amount of annual pension (retirement income payment)
   - RPP defines the formula for determining the pension amount
   - **With DB plans, employer bears 100% of the investment risk**
   - Plans can be contributory or non-contributory, but if it is a contributory plan, employee contributions are clearly defined
   - The cost of the plan to the employer is the total amount of money required to provide the given level of benefits for all plan members
     - If plan is contributory, employee contributions can be offset against the costs

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

Types of Registered Pension Plans (RPPs)

B. Defined Benefit (DB) Plans

- Plan costs are reviewed annually
  - Costs are determined using a given funding method (Actuary required to do this valuation)

- Types of DB plans:
  - i. Flat Benefit
  - ii. Career Average Earnings
  - iii. Final Average Earnings
  - iv. Flexible plans

1. Registered Pension Plans (RPPs)

Types of Registered Pension Plans (RPPs)

B. Defined Benefit (DB) Plans

   i. Flat Benefit - represent about 15% of all DB plans
      - These plans are popular with unions
      - **The retirement pension for this type of plan is a specified number of dollars for each year (or month) of service**
        – There is no earnings recognition in benefit calculation
      - Benefits often "integrated" with CPP/QPP by providing bridge benefits from retirement to age 65
        – Bridge benefits provide an approximately level retirement income to the individual without a sudden increase when government pensions commence

1. Registered Pension Plans (RPPs)

Types of Registered Pension Plans (RPPs)

B. Defined Benefit (DB) Plans

i. Flat Benefit

to administer.
easy to calculate the benefit

- Advantage historically with this plan type was that it was simple to administer, easy for employees to understand
- Disadvantage: flat amount per year of service based on wage levels at time level is established, but pension will be paid in future when wages/prices have ↑ (lack of inflation protection)
- Most flat benefit plans now subject to periodic upgrades to reflect inflation and have become more complex to administer

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

Types of Registered Pension Plans (RPPs)

B. Defined Benefit (DB) Plans

   ii. Career Average Earnings Plans - about 35% of all DB plans

   - **Annual pension benefit is calculated as a certain percentage of earnings in each year of plan membership (equal weight is given to each year's earnings (years of service is considered)**
   - Benefits usually "integrated" with CPP/QPP (and contributions if contributory plan)

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

Types of Registered Pension Plans (RPPs)

B. Defined Benefit (DB) Plans

ii. Career Average Earnings Plans

- <u>Advantages</u>:
  - Easy to administer and understand
  - More manageable employer costs
- <u>Disadvantages</u>:
  - Gives equal weight to employment earnings in each year of an ee's working lifetime, which is not good for ee's that have made significant advancements over their career (lower pension relative to income at retirement in these cases)
  - Equal weight to each year's salary an issue if inflation is high
  - Above concerns sometimes addressed by updating the "plans earning base", which will be illustrated in Example 1b)