Pension and Savings Plans **in Concert**

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We have seen that demographic shifts will increase employer competition for human resources. On the pension and savings plan front, this will likely result in employers combining a variety of designs. The fact is, pension and savings programs of different types appeal to different employees. Some will receive substantial inheritances from their baby-boom parents and be able to take aggressive risk/reward positions with their retirement savings. Given the trend towards multiple careers and an emphasis on self-sufficiency and adaptability, many will want control of their own finances. Others will want to build security and be taken care of. Employee preferences will be diverse.

As competition for human resources becomes more intense, employers will become more responsive to this diversity. To support their ability to recruit and retain across the labour market, they will want pension and savings programs that cater to employees of various types. This will lead to the development of programs that incorporate different types of plans as options and in combinations.

Additionally, employees will want to know that their employer's plans are competitive in the context of total compensation, and employers will want employees to understand and appreciate those plans. Wherever possible, employers will seek a fit between plan design and corporate culture.

In future, employers will build pension and savings programs out of some or all of six components. These components are defined benefit (DB) pension plans, defined contribution (DC) retirement plans, defined contribution (DC) savings plans, true profit-sharing and share-based savings plans, hybrid plans and supplemental plans.

DB PENSION PLANS

DB pension plans cater to employees and potential recruits who seek security and who look to their employer to provide a safe and convenient foundation for their retirement income. This is an attractive target employee group because they will seek long-term careers and be easier to retain than other groups.

This category covers a broad set of retirement plans, all of which offer pensions determined according to a set formula. In many DB plans, the benefit and contribution formulae have carve-outs to integrate them with the Canada and Quebec Pension Plans.

In collective bargaining situations where unions negotiate on behalf of groups of workers with fairly homogeneous earnings levels, the flat benefit plan is common. In flat benefit plans, the pension earned each year is expressed as a fixed dollar amount. For example, a plan giving $50 per month per year of service will provide a pension after 30 years of $1,500 per month, or $18,000 per year. These plans often have periodic updates to compensate for inflation. The unions and the employer negotiate the formula going forward, along with any updates for past service.

DB plans often help retain employees up to an early retirement age such as 55, and facilitate early retirement after that age. With future skills shortages on the horizon, employers may redesign these plans to provide more incentive to continue in employment up to and beyond current normal retirement age, and to accommodate periods of transition to retirement. For instance, they may allow employees to work part-time and receive partial pensions, a concept pioneered in Quebec and now spreading across Canada.

DC RETIREMENT PLANS

DC retirement plans cater to the preferences of employees who want control over their retirement savings, full portability of their entitlement and/or a say in the investment of their funds for retirement.

Under these plans, contributions are usually expressed as a percentage of pay and are accumulated in investment accounts. These accounts are then used to provide retirement income. Often, the employee has considerable choice as to how the funds are invested.

DC retirement plans include DC pension plans (also known as money purchase pension plans), which are registered under tax legislation and locked in under provincial or federal pension standards legislation. They also include locked-in group registered retirement savings plans (RRSPs). These are RRSPs that prevent withdrawal of contributions during, and in some cases after, employment.

The locking-in provisions of these plans ensure that money is accumulated for retirement and not spent on other purposes. Group RRSPs can include provisions to accommodate members who want to use their funds to invest in education or in a first-time home purchase. They also offer spousal accounts for income splitting.

DC SAVINGS PLANS

DC savings plans are like DC retirement plans. But by allowing withdrawal rights during employment, they do not require that the funds be used for retirement income. This flexibility will appeal to those employees who seek more autonomy in managing their finances.

DC savings plans come in many forms. Tax-sheltered varieties include group RRSPs and deferred profit-sharing plans.[1]

With the growth of financial and retirement planning education that helps employees estimate the funds necessary to top up plan benefits to target levels, savings plans are evolving to accommodate optional additional contributions. Employers can present such plans as vehicles for overall employee saving. They usually offer low expense charges along with excellent and unbiased financial information and education.[2]

As more employees use employer plans to save, we will likely see the growth of non-registered components to more fully accommodate voluntary contributions and transfers-in.

For employers, this will be an inexpensive way of providing a service that appeals strongly to many employees. Employers will complement their savings plans by including more and better financial and retirement planning and education services in their offerings.

TRUE PROFIT-SHARING OR SHARE-BASED SAVINGS PLANS

These plans help employers create corporate cultures that foster a sense of ownership. As employees adapt to a fast-changing marketplace and multi-career job progression, they will develop entrepreneurial business attitudes in the management of their own careers. An entrepreneurial employment environment and sense of ownership will appeal to a growing number of them.

These plans are generally like DC savings plans, except that the contributions will vary with profits and/or consist of company stock or stock-based holdings such as stock options.

Stock plans involve actual or potential share ownership. Contributions to true profit-sharing plans are akin to dividends. These plans therefore place employees in a similar position to shareholders and, when backed by appropriate communications, offer potential to support a culture of alignment between employee and shareholder interests.

HYBRID PLANS

Hybrid plans may combine attractive features of some of the above components. For instance a flexible pension add-on to a DB pension plan allows for accumulation of additional funds under a DB structure in a way that has many of the features of an unusually tax-effective DC retirement plan.

As competition for labour drives employers to differentiate themselves through innovation, new hybrid designs will emerge. One of the most important of these is likely to be the target benefit plan, a design that offers employees a DB promise that is subject to an affordability test. The affordability test will share the funding risk between employees and the employer and foster a culture of partnership and mutual responsibility. This design will allow the employer to offer a modified DB promise, without exposure to the balance sheet liabilities that may arise from DB pension plan accounting rules.

SUPPLEMENTAL PLANS

Supplemental plans will allow employers to cater to needs that they cannot accommodate through other components of their program. In particular, they will provide useful assistance with the hiring and retention of high earners and employees on international assignments.

A supplemental plan can wrap around any of the above types of plans, but most will be associated with registered arrangements where benefits are subject to tax limitations. Many supplemental plans that exist today provide top-up pensions or contributions in excess of the limits permitted under registered plan tax rules. Many are unfunded promises to pay the benefits when they fall due and are subject to the employer's financial ability to honour them at that time. Some are pre-funded as retirement compensation arrangements or other types of plans. Pre-funding provides security, but comes with a tax cost.

Supplemental plans will be useful in recruiting situations where the candidate faces pension losses on leaving an existing employer's plan to accept a job offer. They will also be helpful in ensuring that employees on international assignments can move from country to country without incurring pension losses. Finally, if structured outside the scope of provincial pension legislation, supplemental plans can incorporate strong vesting features, which will assist in retention of key employees and executives.

PUTTING THE PIECES TOGETHER

In order to appeal to a wide spectrum of employees, progressive employers will combine the above components in ways that project diverse and vibrant images. Such combinations may be constructed as multi-component plans and they will generally involve employee choice. They may have varying degrees of built-in prudence.

For instance, many employers will want to ensure that there is a retirement plan to provide a floor of protection and some may want to keep the use of true profit-sharing and share-based plans consistent with moderate concentration of risk.

Here is one example of what a plan of the future might look like:

Component A

- *Retirement plan.*
- *Choice between target benefit and DC options.*
- *Supplemental plan to deal with tax limits, international employees and pension losses at hiring date.*

Component B

- *DC savings plan.*
- *Optional contribution levels.*
- *Tax-sheltered and non-tax-sheltered options.*

Component C

- *True profit-sharing plan.*

General choices

- *All component A.*
- *Half component A, with the other half split between components B and C according to the employee's election.*

Employers will seek to provide employees with online access to attractive illustrations of total compensation value. With the advent of web-based pension administration systems and modelling tools, employees can now go online and do what-if projections of fund accumulations or pensions. Employers are enhancing these tools to show employees the value of their programs expressed in total compensation terms, that is, as equivalent additional salary.

This is now possible even with DB pensions. Employees can model the annual compensation values of such plans in different scenarios — for example, employees can get estimates of the annual compensation value of their pensions should they decide to leave the company after five years of service or work to a given retirement age. Employers are beginning to use such projection tools as part of their recruitment packages.

By illustrating the extra value these plans produce at retirement, projections will help employers use pension retention power to the full.

Employers will design communication programs to provide clear and well-presented explanations of the options available to their employees. They will emphasize connections between their programs and corporate culture objectives. For instance, a range of plan options will support a culture of employee empowerment and flexibility and a significant profit-sharing or share-based component will help align employee and shareholder interests.

Properly managed, Canadian retirement and savings plans will help employers deal with the competition for human resources. To attract and retain employees from a talent pool with diverse preferences, progressive employers will cater to those diverse preferences by offering innovative combination plans.

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[1] Many deferred profit-sharing plans are not really profit-sharing plans; contributions are fixed percentages of pay rather than of profits. The confusing terminology arises because the relevant Income Tax Act provisions originally contemplated true profit-sharing plans.
[2] It should be noted that employee contributions are not allowed in deferred profit-sharing plans.

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