



International Society
of Certified Employee Benefit Specialists

What faces a defined contribution plan retiree and why they need help?

Neil Lloyd, Western Canadian Wealth Leader

ISCEBS Alberta Chapter
19 April 2023



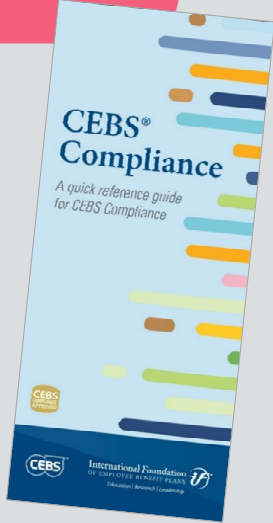
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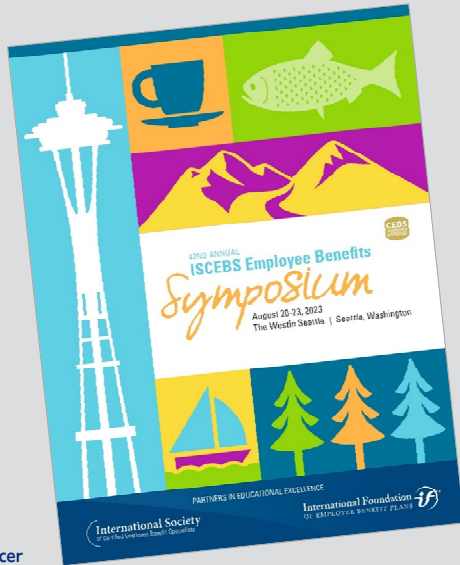


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- August 20-23, 2023
- The Westin Seattle
- Seattle, Washington

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welcome to brighter

What faces a defined contribution plan retiree and why they need help?

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A business of Marsh McLennan

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Disclosure

- Many of the issues discussed can be quite detailed and technical. This presentation is not intended to provide all the details, but may oversimplify to give a “sense” of these issues, and how they potentially could impact/benefit you.
- You should not act based on the information presented here but use this as a way to highlight issues worth looking into in more detail.
- **For more information on Government Benefits contact Service Canada at 1-800-277-9914 or www.servicecanada.gc.ca**
- **For more information on Tax issues (eg Income splitting) <https://www.canada.ca/en/revenue-agency/>**

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1. Retirement plan landscape
2. What does influence retiree decisions?
3. What can we learn from others' experiences?
4. Some final suggestions that can help

Agenda

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Retirement plan landscape

A large, bold, blue number '1' is positioned in the bottom right corner of the slide, indicating the first item on the agenda.

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Retirement plans overview

Landscape in Canada



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Retirement plans overview

Government Sponsored Programs – in Brief*

Canada Pension Plan (CPP)

- Benefit is based on how much, and for how long, you contributed, during employment in Canada and at what age you choose to retire
- Expanded to increase benefits and contributions starting Jan. 1, 2019

Old Age Security (OAS)

- Based on length of residence in Canada
- Full or partial benefit available

Guaranteed Income Supplement (GIS)

- Available for low income earners
- Non-taxable

Target of 25% replacement moving to 33% (Limited by YMPE)

Target approx. 13% for average earner

Maximum Benefit

CPP	\$1,306.57 per month (\$15,679 per year)
OAS	\$687.56 per month* (about \$8,251 per year)
Total	\$1,994.13 per month

That's about **\$23,930 per year** of taxable income

* For Q1 2023. Indexed quarterly, so amount is approximate and subject to change.

* Note: these slides are an oversimplification to give a "sense" of these benefits. For more information on Government Benefits contact Service Canada at 1-800-277-9914 or www.servicecanada.gc.ca

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Government benefits

Useful to know*

- **Early Retirement (age 60 to 65)**

- The reduction at age 60 is 0.6% per month (7.2% per year)
- Over five years the reduction is 36% (7.2% x 5 years)

- **Postponed Retirement (age 65 to 70)**

- The premium is 0.7% per month (8.4% per year)
- Can start pension as late as age 70, resulting in a 42% premium over the pension that would be payable at age 65

Other:

- Indexed annually – very valuable benefit!
- Taxable
- Personal statements available (upon request)
- Income splitting possible, but you must apply
- Benefit is divisible on marriage/relationship breakdown
- Also provides death benefits, survivor benefits, and disability benefits

* Note: these slides are an oversimplification to give a “sense” of these benefits. **For more information on Government Benefits contact Service Canada at 1-800-277-9914 or www.servicecanada.gc.ca**

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Employment-related retirement provision

Q:
So how many
different employers
have you had?

- A:**
1. One employer
 2. Two employers
 3. Three employers
 4. Four employers
 5. Five to nine employers
 6. Ten plus employers

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Employment-related retirement provision

Research suggests that Canadians may hold about **15 jobs** in a lifetime today.

- "How Often Do People Change Careers in Canada?" September 16, 2019 www.columbia.ab.ca

If the current trend continues Canadians can expect to hold roughly **15 jobs** in their careers

- "How many jobs do Canadians hold in a lifetime?", 12.04.2014 www.careers.workopolis.com

Even where Canadian do work for employers with retirement plans they may end up with many "pots" of small retirement amounts

Complex to deal with

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Retirement plan overview

Types Of Plans

Pension Plans



- **Defined Benefit (DB)**
- **Defined Contribution (DC)**
- Hybrid (DB & DC)
- Target Benefit Plan
- Pooled Registered Pension Plan (PRPP)

Savings Plan



- Deferred Profit Sharing Plan (DPSP)
- **Registered Retirement Savings Plan (RRSP)**
- Employee Profit Sharing Plan (EPSP)
- **Tax Free Savings Account (TFSA)**

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What retirement options are typically available?

Depends – some possibilities



Lifetime annuity, maybe with dependents benefits

- In plan: typically defined benefit plans
- Open market



LIF or RIF (periodic withdrawals from investment account) – Minimum and maximum annual withdrawals may apply

- Offered by recordkeeper
- Possibly in plan
- Open market



Cash, but this may be limited



Variable Payment Life Annuity ("VPLA") - lifetime annuity payments that change depending on market performance



Combination of the above



Other

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Issues to consider when reviewing retirement options

- What options are available to me?
- There are a **lot of new products** available and a lot of **acronyms**
 - Talk to someone about the differences
 - Learn the pros and cons
 - **Find a product or products that suit your needs**
- Fees:
 - Can have a significant impact on your net return.
 - Be realistic about the amount of advice and assistance you need. The lowest fee option may not be right for you.
 - Be aware that in many cases advisors receive commissions, bonuses and incentives that may differ depending on the product you buy. *"Don't expect the Ford dealer to recommend a Toyota."*

Sometimes an adviser or service is available to assist you, but try and understand their incentives

OR

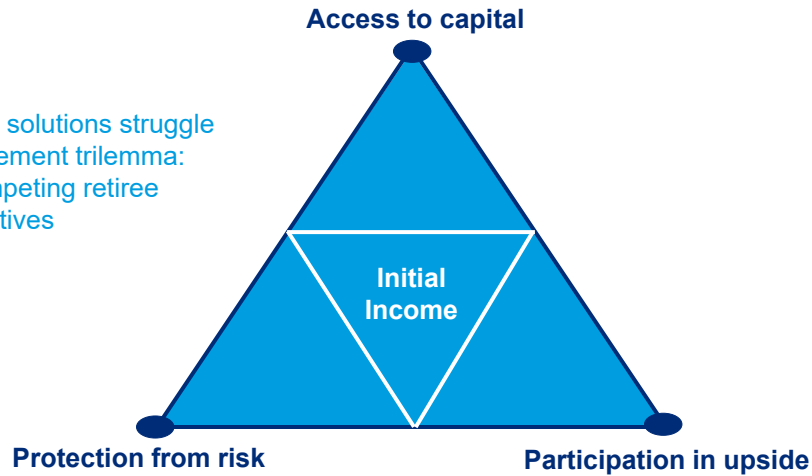
"Don't expect the mutual fund salesperson to sell you an annuity."

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The retirement trilemma

How to view solutions: simplified

Retirement income solutions struggle to solve the retirement trilemma: balancing competing retiree objectives



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More complex (in depth): Theoretical evaluation framework

Retiree/Participant Perspective

Initial income generation

- | | |
|---|--|
| Protection from risk/
Income and
Capital
stability | <ul style="list-style-type: none"> • Longevity risk • Inflation risk • Insurer credit risk • Downside market risk • Annuity conversion rate risk • Terms and conditions risk |
|---|--|

Participation in upside

Access to capital/Interest in a bequest

Fees

Is the product understandable?

Advice/guidance conflicts (confusion)

Enabling flexibility

A challenge: do we help with rules of thumb or do we highlight all the questions to ask and confuse people in the process?

In reality we know that this is not how most retirees make decisions

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What does influence retiree decisions?

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Behavioral influences: Endowment (wealth) effect

Where people tend to value more highly something they own more than something they do not (even if they are equivalent)



This may explain why a person who has built up say \$500,000 does not want to lose that wealth:

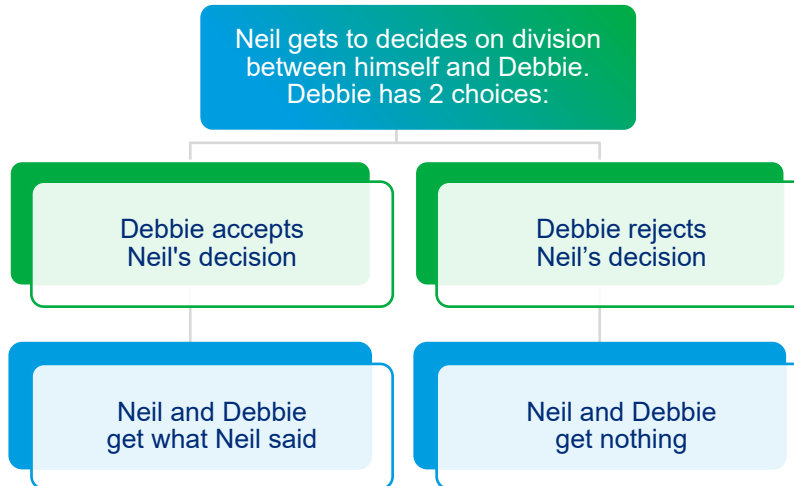
- Negative view if depleting wealth by transferring say \$250,000 to an annuity
- Explains why US experience is that on average retirees tend to maintain wealth into retirement (not spending down capital into retirement)

Knetsch, Jack L. (1995). "Asymmetric valuation of gains and losses and preference order assumptions". *Economic Inquiry* 38, 138-141.

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The importance of perceived fairness

Ultimatum game: Sharing \$XXXX



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The importance of perceived fairness

If we have \$1000 to share, I am feeling greedy. My offer is I will take \$800 and you can keep \$200.

1. Do you accept the deal?
i.e. accept the \$200
2. Do you reject the deal?
i.e. walk away with nothing



1. Accept the deal



2. Reject the deal

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The importance of perceived fairness

So how does Debbie respond?

Repeated across the world

- Offers of 20 percent or less: rejected about half the time

Rejection rate decreases:

- As the division becomes fairer, and
- As the amount being divided increases

Is this rational?

- *Fairness* is a good that people value

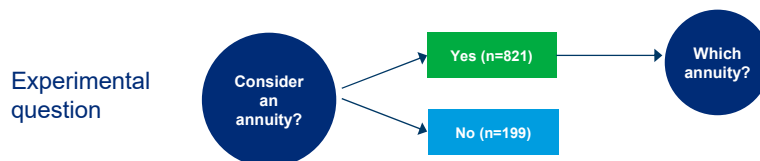
The issue of fairness arises often in feedback from retirees.

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Research by behavioral scientists

Suzanne Shu researched who says they are interested in an annuity

A substantial proportion of respondents do not like annuities at all (~20% across all tasks)



Who never picks an annuity?

- No significant effects of age, education, or income
- Annuities disliked by individuals with highest savings (>\$150K), with the **highest risk aversion (risk aversion is the risk of passing away and not using their retirement assets)**

- Annuities most strongly disliked by those who see them as unfair

Source: Suzanne Shu, DCIA Webinar, August 22, 2019, "How Behavioral Finance and Psychological Biases Can affect Retirement Income Decision Making"

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The breadth of risks facing retirees

Society of Actuaries : 2020 Retirement Risk Chart

Economic risks	Personal planning considerations	Unexpected/unpredictable events
Inflation	Longevity	Public policy changes
Interest rates	Post-retirement employment	Significant health care needs
Financial markets	Changes in housing and support needs	Unforeseen needs of family members
Employer solvency	Change in marital or partnership status: Death	Bad advice, fraud or theft
	Change in marital or partnership status: Divorce, separation or remarriage	

Most retirement solutions or thinking focus on inflation, interest rates, financial markets, longevity and maybe health care. But focus groups and surveys show that retirees have a broader set of uncertainties.

The breadth of risks facing retirees coupled with the long time horizon leads to a rational response: the need for a retirement strategy that can be **flexible and adapt as needs change**.

Source : "Managing Post-Retirement Risks: Strategies for a Secure Retirement", Society of Actuaries, 2020

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What can we learn from others' experiences?

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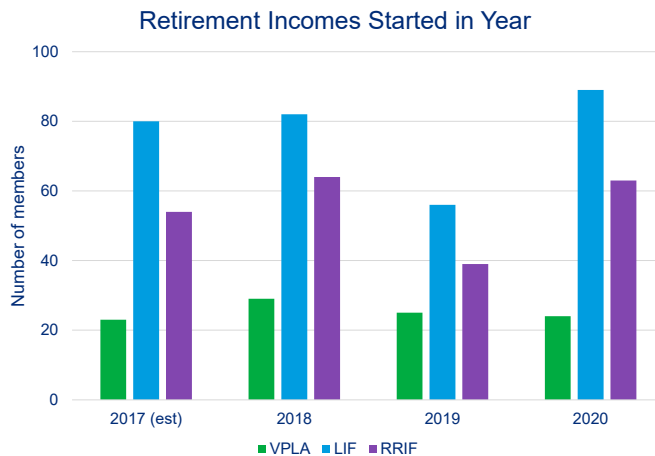
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Canada: University of British Columbia experience

Renowned for offering Variable Payment Life Annuity (also offer a LIF)

But only 16.1% take VPLA and per 2016 less in assets

UBC also offer support/guidance



Without guidance will almost never select the VPLA

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Canada: Other developments



(With a few exceptions) in order to draw income retirees had to transfer to a LIF or RIF

- Some provinces allow for income to be paid from a DC plan
- Most recordkeepers only have the capability to transfer to a LIF/RIF
- Some employers offer a LIF/RIF that mimics their DC plan – typically reduce fees



VPLAs will ultimately allow variable benefits to be paid directly from DC arrangements

- VPLAs would avoid the requirement to transfer funds to a LIF or RIF
- The Income Tax Act framework has been developed and legislative developments are ongoing across various jurisdictions across Canada
- Dynamic Pension Pools (a renaming of the VPLA) promoted by National Institute for Ageing and the Global Risk Institute

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United Kingdom: What can we learn from UK experience?

Pension Freedom



From April 2015, individuals with a defined contribution pension will have the freedom to access their pension as they wish from age 55¹

- Prior to 6 April 2015, you almost always had to buy an annuity with your retirement assets



According to a 2018 article²:

"...while about 90 per cent of people bought an annuity back in April 2015, now a mere 12 per cent are choosing an annuity."

¹Pension freedoms protected and new breed of pension schemes become law - GOV.UK (www.gov.uk)

²State of the annuity market 3 years after Armageddon - FTAdviser.com

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Australia: The QSuper response

Key features

- A variable annuity that took inspiration from the UBC VPLA
- 2 key design principles : Compelling and Simple
- Product design was focus group tested



Recap of product features

QSuper Lifetime Pension



Income for life

Fortnightly payments for the rest of your life



Higher income

Market linked with an annual adjustment¹



Potential Age Pension benefits

Discounted assets test



Optional spouse protection

Payments continue if you pass away



6-month cooling-off period

Providing time to decide if it's right for you



Money-back protection

Receive at least your money back as income or the remainder as a death benefit²

¹ Income can go up or down depending on pool performance. ² Subject to a legislated maximum in limited circumstances

Note participant feedback repeatedly shows the importance of a death benefit to address the severe risk of what happens if they die early

Designed to be used together with a traditional drawdown strategy

Expectation was that:

- Members with limited savings can rely on Age Pension (i.e. do not need Lifetime Pension)
- Members with adequate savings will be self-sufficient (i.e. do not need Lifetime Pension)
- Lifetime Pension would be for those members in between

None of this proved to be true!

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Australia: The QSuper response

Who really uses Lifetime Pension?

Who is it REALLY designed for?



Ravi, \$180k
"My greatest fear is being financially reliant on others in my old age."

Rachel, \$250k
"I'm not very good with money. I'd love a reliable income that never runs out."



David & Rosemary, \$600k
"This would be ideal – giving us higher income with a bonus of the age pension benefits."

Amanda, \$800k
"I'm looking for the same peace of mind in retirement as I've had with my DB account."



Linh & Trang, \$1m
"Just tell me how much I need to put in to get a Pension Concession Card."

Michael & Lisa, \$2m
"I want to set Lisa up with a Lifetime Pension for peace of mind after I'm gone."



© QSuper Board

*Fake photos and names

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Key learning is that **individuals have their own reasons for making decisions that cannot always be predicted.**

The decisions may not always appear as expected. But for the retirees themselves they may be good choices that either give greater comfort or greater satisfaction.

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Some final suggestions that can help

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As an employer offering a retirement plan



Ask your recordkeeper (or in a recordkeeper review)

- What support do you provide retirees?
- What products do you offer to our retirees? Are the fees reasonable?



As a plan sponsor, would you be open to sponsoring a LIF/RIF that mimics your retirement plan?

- Lower fees for retirees
- Same investment line-up they know
- Economies of scale for retirees and plan members



Explore more ways to assist retirees

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Help employees select a financial advisor

Questions to ask your financial advisor

1. What are your qualifications? (e.g. professional credentials)
2. What experience do you have? (e.g. areas of specialty, types of clients)
3. What services do you offer? (e.g. retirement, investment, tax, estate planning)
4. What is your approach to financial planning? (e.g. holistic, stock brokerage)
5. Will you be the only person working with me? (e.g. access, level of contact)
6. How will I pay for your services? (e.g. fee-for-service, sales charges, trailers, % of assets)
7. How much do you typically charge? (e.g. typical annual amount)
8. Could anyone besides me benefit from your recommendations?
9. Are you regulated by any organization? (e.g. FPSC, securities regulator)
10. Can I have it in writing? (e.g. written engagement letter, references)

Source: FP Canada (fpccanada.ca)

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Help employees select a financial advisor

Signs of a Good Financial Advisor

- Has a professional designation
- Can provide references
- Wide variety of products available
- Can provide at least two alternative options to you
- Can you tell all the CONS of his / her ideas
- Will tell you what kinds of products they DON'T offer that might suit you
- Takes time to talk about your needs/plan, not just the products they sell
- Makes you feel like you can contact them

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As an individual: How to select a financial advisor

Ideas for finding a good Financial Planner

- Ask friends / colleagues whom they use and what they think of them
- Are there advisers suggested by your employer?
- Start with some quick phone interviews
 - Ask about services / fees / range of products
- Talk to more than one, and in person (should get free initial consultation)
 - Try your bank
 - Full service broker (maybe even two)
 - Ask the ten questions shown earlier
 - Discuss their financial planning process
- Take your plan from one to another for comment
- Go where you're most comfortable or DIY (do it yourself)

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Income splitting

Income splitting permits income shift from one spouse (or common-law partner) in a high tax bracket to the other spouse (or common-law partner) in a lower tax bracket

For those individuals under age 65, eligible pension income includes:

- Lifetime annuity payments under an RPP
- Certain RPP payments received on death

For those individuals over age 65, eligible pension income includes:

- Lifetime annuity payments under an RPP, RRSP, or DPSP;
- Payments out of an RRIF or LIF
- Interest portion of a prescribed annuity

For all individuals, eligible pension income excludes:

- Payments from OAS or CPP
- Payments from Retirement Compensation Agreements
- Payments from an unfunded Supplemental Employee Retirement Plan

* Note: these slides may be an oversimplification. **For more information on income splitting review**
<https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/pension-income-splitting.html>

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Income splitting

- CPP
 - Even though CPP is not eligible pension income, CPP can be assigned from one spouse to the other and directly paid by the government to the recipient spouse
- In order to split income, a joint election in prescribed form must be completed with the income tax returns and filed by the due date.
- Pensioners need to determine the optimal amount of pension to split, based on tax brackets, various tax credits and OAS refund rules

Income splitting can make a big difference but it can be tricky. You may need help

* Note: these slides may be an oversimplification. **For more information on income splitting review**
<https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/pension-income-splitting.html>

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Income splitting

An indicative example

Before

Member Eligible Pension Income \$70,000

Member Non-Eligible Pension Income \$30,000

Spouse Income \$15,000

Member Taxes \$27,565

Spouse Taxes \$0

Total After Tax Income \$87,435

After

Member Eligible Pension Income \$35,000

Member Non-Eligible Pension Income \$30,000

Spouse Income \$50,000

Member Taxes \$16,890

Spouse Taxes \$12,500

Total After Tax Income \$89,360

\$1,925 in annual savings

* Note: these slides may be an oversimplification. **For more information on income splitting review**
<https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/pension-income-splitting.html>

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**Thank you for your
time and attention
to an important
issue that is not so
simple**

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