

Canada's younger generation needs a new pension tool

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Ottawa recently introduced proposed changes that would amend federal pension laws to permit federally regulated employers to provide a pension plan with a target-benefit design.

Briefly, the proposed changes would make it easier for employers to offer another registered pension option beyond the usual defined-benefit (DB) or defined-contribution (DC) models. If you accept that it is sound policy for government to promote employer-sponsored pension plans in order to contribute to the financial security of Canadians in retirement, the critical question is how best to deliver.

It is fair to say there is no one pension model that is the "right" one for all work forces, and pension legislation should allow a company to find the right balance between pension risk and its overall compensation strategy.

Why target-benefit plans? These plans are similar to DC plans in that the contributions are fixed, thereby providing employers with cost certainty. Target-benefit plans also share some important features with DB plans; specifically, target-benefit plans pool longevity risk and investment risk. That is, the investments are pooled and professionally managed (instead of individuals having to make investment choices). On the longevity side, an individual does not have to speculate how long he or she may live and hope that he or she will not outlive his or her savings, as the risk is pooled among all the plan members. Target-benefit plans also provide a targeted DB-type benefit based on a formula set out in the plan, so members will have a good idea of the amount of monthly income they can expect in retirement. If the targeted pension cannot be attained, benefits under a target-benefit plan may be reduced.

Under the proposed legislation, current individual DB or DC benefits may be exchanged for target benefits if the individual consents, or the applicable union consents on behalf of its members. If there is no consent, there is no change to the accrued benefits and any target benefits could only be provided on a prospective basis.

Critics of the proposed changes appear to be of the view that plan members may be effectively forced to convert or lose their accrued DB benefits, which is simply wrong in a consent-based model.

The proposed changes should be supported, as it potentially gives the younger generation a shot at a pension plan that shares some attributes with a DB plan and is not just a savings account (as in the case of DC plans or group RRSPs). If we look at what has been happening over the past several years in the private sector, we have witnessed companies shifting out of DB plans in favour of DC plans (or other cost-certain retirement savings plans, such as group RRSPs) in droves. In many cases, DB benefits are preserved for active members, but there has been a shift to DC for future hires (generally, the younger generation).

Many private-sector companies that have not yet made the shift to DC for future accruals or

future hires continue to regularly consider whether they should be moving to DC in order to attain some cost certainty and manage risk. For a work force in which DB may historically have been appropriate, a company considering pension change in order to attain cost certainty might consider a target benefit for new entrants instead of DC. From an employee's standpoint, if DB is the gold standard, target benefit is arguably the silver and DC is the bronze along the spectrum of pension design.

By opposing the changes, the critics of the proposed legislation seem to support DC over target benefit, which is perplexing, to say the least. Or perhaps the concern rests with preserving what is in place for current employees without regard for what the pensions for the next generation will look like.

Allowing for target benefits as a design option for federally regulated employers is a welcome change. Rather than casting stones at the government for proposing this change, we should be thankful the current government is willing to make changes in the pension industry to provide different pension tools for an employer to meet its compensation goals. Having target benefit as an option has the prospect of being most influential for the younger generation in the private sector. What's the problem with that?

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