Summary of presentation by Robert L. Brown
W12: Beyond DB and DC—Alternatives for Risk Sharing Between Employees and Employers

This presentation was based on a recent paper: Pooled Target Benefit Pension Plans: Building on PRPPs written by Robert L. Brown (the presenter in W12) and Tyler Meredith. The paper can be found on the web site of the Institute for Research on Public Policy or: www.irpp.org. The ppt presentation can be found on the conference web site.

Presentation Summary

More than 60 percent of working Canadians currently do not have a workplace pension (75% in the private sector). Even for those who do have one, it often does not guarantee them retirement security. With employers increasingly opting for defined-contribution (DC) rather than defined-benefit (DB) pension plans, the burden of managing the risks associated with a pension — such as longevity and the market performance of assets — has shifted to the worker.

While this shift may have curtailed pension costs for businesses, as Robert Brown and Tyler Meredith argue in their paper, it has also left workers more vulnerable financially, since many do not have the skill set necessary to plan effectively for retirement. In their study, the authors explore ways to improve pension coverage and better manage risk for pension members, while also providing cost predictability for employers.

With respect to the policy reform proposals currently on the table in Canada, although expanding the CPP/QPP would be worthwhile, it is unlikely to be undertaken in the current economic and political environment. Meanwhile, the concept of Pooled Registered Pension Plans (PRPPs), recently introduced by the federal government, lacks mandatory employer contributions and will do little to reduce risks for individuals.

The authors instead propose a voluntary Pooled Target-Benefit Pension Plan (PTBPP). It would involve commingling assets across many participating workplaces to maximize scale efficiencies in investment and manage actuarial risk (asset pools would have to be at least $10B). Employers' matching contributions would be mandatory but fixed, as in a DC plan. As with the PRPP, it would be available to individuals and the self-employed.

Most importantly, upon retirement, members could expect a benefit within a target range, depending on market performance. The authors suggest a minimum benchmark of 50 percent income replacement, requiring a slightly higher contribution rate than in many DC plans today (10% versus 8.7%). This 50% benefit plus the Canadian C/QPP and OAS (which provide a 39% replacement for a worker at the average wage) would provide an appropriate level of retirement income security.

While the target-benefit design would not eliminate the risk that benefits could decrease due to market underperformance, the model proposed includes mechanisms to mitigate this risk. The plan would be managed by actuaries and investment managers, instead of by workers. To curtail administrative costs, the PTBPPs would be required to maintain a minimum pool of $10 billion, with management fees capped at 40 basis points, which would be considerably more cost-efficient than are most DC plans and RRSPs today (250 to 300 basis points).

In sum, for employers the proposed model would provide protection from pension cost volatility, and for employees it would offer more effective retirement saving through low administrative costs and reasonable retirement benefits. For many workers and employers this would be a vast improvement over their situation today.

Brown's presentation concluded that the PTBPP could be implemented within the legislative framework recently created for PRPPs, but this would require concerted action by the provinces.

Questions and Commentary

Most questions were seeking clarification on details of the Target Benefit concept. Brown pointed out that there could be a wide variety of plan models that could work effectively and be classified as Target Benefit Pension Plans. Examples in Canada include the Quebec Member Funded Pension Plans and several public sector plans such as the Teachers' Plans in Nova Scotia, Ontario and BC.

Other questions probed into some of the existing "Automatic Balancing Mechanisms" around the world; in particular, plans where benefits adjust automatically for changes in population life expectancy (e.g., Sweden).

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