RCF News

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Guaranteed Target Benefit Pensions/SERPs

By Roy W. Craik

Defined Benefit Pension Plans (DBPPs) are the most desired by Employees. They are also the most costly to the company sponsor. Defined Contribution or Money Purchase Pension Plans (MPPS/RRSPs) are more attractive to Employers but more worrisome to Employees. For this reason, there is much talk about Pooled Target Benefit Pension Plans (PTBPPs). Many think PTBPPs are a compromise, giving more retirement security to Employees, at a more manageable cost to Employers. This could well be the case. However, required legislation could be some time coming.

Employee Concern

Employees are worried. For those retiring in 2012 the DBPP limit is $2,646.67 for every year of service (irrespective of final average earnings - discriminates against higher earners). For 25 years of service, an employee could have approx. $66k a year in guaranteed benefits (reduced if Jt/Survivor election). Those in MPPPs/RRSPs are not as lucky and, do not have that same level of security. In fact, given today's investment climate, most Employees have no real idea what their retirement income will be. It is a guesstimate at best for most.

Pensions came to the labour market to generate loyalty and provide incentive to stay with a company to retirement**. Today, the sad reality in many companies, is that Shareholders, Banks and other capital lenders have become more important than the Employees that generate the income.** Under current legislation in bankruptcy situations, even employees participating in a Defined Benefit Pension can lose a large portion of their benefits if the plan was under-funded at bankruptcy.

This does not have to be the case. There is no reason to wait for PTBP legislation which, in any event, is only likely to guarantee contributions, not final benefits.

Employer Solution

For fair-minded Employers, current legislation allows for the establishment of Defined Benefit SERPs, secured and, with fully deductible funding using the Retirement Compensation Arrangement (RCA) provisions of the Income Tax Act. **Grateful Employees** will be motivated to stay with their Employer until normal retirement to collect. **Shareholders/Owners** are rewarded in the long-term by the retention of their most valuable asset, an experienced and loyal work force.

Gross Benefits

Under "Generally Accepted Guidelines", target pensions in Canada are 2% x years of service (max 35 years) x final average earnings. With benefit caps on DBPPs, contribution caps and a volatile investment environment for MPPPs/RRSPs, it is unlikely that target levels will be met. As worrisome, is the ability of an Employee's other investment assets to make up the shortfall in pension benefits. By the time most Employees hit retirement, have paid off their mortgage, educated their children and, perhaps invested in a recreational home, they have little in other investments. Potential inheritances can be delayed/reduced if parents live beyond normal life expectancies. In fact, some retirees might have to provide financial assistance to parents.

Pension Income for most retirees is the most important and critical component of their retirement. The loss of even $2k to

$3k monthly can turn a happy retirement into one of despair. Even for higher earners and those in the C-Suite, the loss of 20% to 30% (if not more) of their pension, could seriously jeopardize their retirement plans.

Target Benefits

What every Employee needs is a minimum guarantee (1% x years of service) to provide **"Living Money".** For enjoyment in retirement, the **"Play Money"** comes from the remaining 1% x years of service. If investments do not perform in the RRSP or MPPP, all is not lost.

Retirement Security comes at a cost, which most Employees well understand. The "quid-pro-quo" so to speak is for SERP Members in the Group RCA to allow a mortality component be added on their lives and held as an asset of the Group RCA.

Group RCA

Utilizing a Group RCA for all employees and investing contributions in the Participating Pools of assets of major Insurance Companies via individual contracts on SERP members, guaranteed benefits can be provided to SERP members. As well, "exempt" insurance contracts held by RCAs compound tax-sheltered assets until death thus allowing loans against the guaranteed values for net benefit payments (after refunds from Refundable Tax Account) thus increasing efficiency of RCA Investment Account.

Yield

Today, yield is elusive. Professional managers are probably more capable of finding yield than most individuals. Insurance companies have dozens of Professional Managers managing their Multi Billion dollar participating pools of assets. By transferring the Group RCA's Investment Account assets to these pools as part of a "layered mortality plan" on lives of SERP Members, they receive the 1% x year of service guaranteed benefit and, the Plan Sponsors' cost of the guarantee is mitigated**. A win-win for Employer and Employee.**

Summary

There is much talk of **"pension problems"** and **"shortfalls"** but little action. Employees want solutions. Companies that grasp and take the initiative will be rewarded. Those that do not, risk the loss of key employees to other employers**. For Empathetic Employers** that understand the pension dilemma and the need for guaranteed **"Living Money",** Guaranteed Target Benefit SERPs funded and secured by Group RCAs are the solution.

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Roy W. Craik is the founder and Chairman of RCF. He has over 40 years experience in the design and funding of SERPs.

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