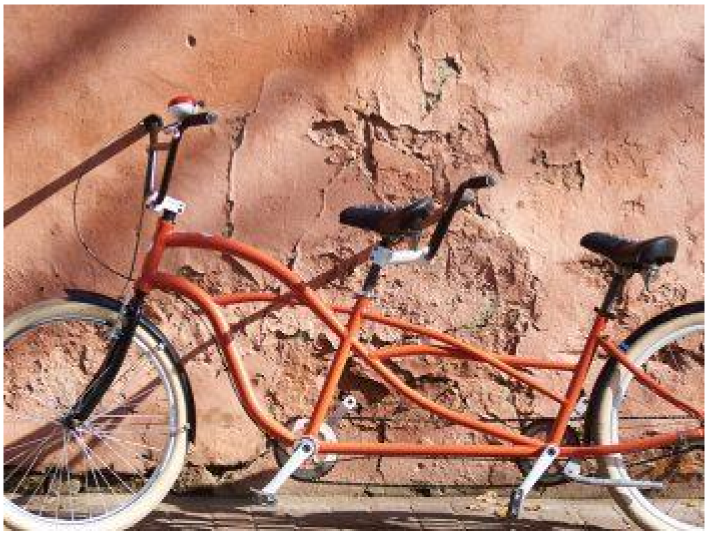
2019 CAP Suppliers Report: A look at the RRSP-DPSP combination



Alethea Spirdon | December 20, 2019

The Swedish word "tack" translates to "thank you," which is precisely what IKEA is saying to employees with its Tack! loyalty program. In Canada, the program operates as a deferred profit-sharing plan and is part of employees' total rewards package.

"The [program] was launched in 2013 based on the wish of IKEA founder Ingvar Kamprad to share the success of IKEA with all co-workers around the world," says Kristin Newbigging, public relations leader at IKEA Canada.

Since then, the organization has paid out €612 million globally. The funding, she says, is divided between all of IKEA's operating countries and is based on each country's proportion of total salary and wages. The payout depends on the company's total results in the previous financial year.

Read: Keeping it simple: Ikea's DPSP reinforces founder's values

"Last year, every full-time co-worker in Canada who has worked at IKEA for a full fiscal year received $1,498, regardless of their position or salary level," says Newbigging. "Eligible part-time co-workers will also receive a proportional amount in relation to hours worked."

The program's structure is a combined group registered retirement savings plan and a DPSP, where employees are encouraged to contribute to the RRSP and the company matches contributions in the DPSP up to a certain percentage after three months of service.

As more plan sponsors look at the RRSP-DPSP combination for their employees' retirement savings, what benefits and downsides should they be considering?

The benefits

When Rosalind Gilbert, senior actuary and associate partner of retirement and investment consulting at Aon, is talking to companies about introducing a new capital accumulation plan, or just revisiting their existing plan design, she lays out the different options and the benefits of choosing one over the other.

"And really, the general choices, assuming the focus is retirement savings, are a registered DC pension plan, the group RRSP or the group RRSP-DPSP combination. When we first started explaining [the RRSP-DPSP structure] to employers, there was an initial concern it would be confusing to employees . . . so I think that means the record keepers are focusing on trying to simplify communications, making sure it looks like one plan, even though it has two components."

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Under the structure, both plans have a tax-deferral mechanism that helps members set aside money for retirement, says Anne Ananddakopal, principal of defined contribution consulting at Morneau Shepell Ltd.

While plan members are contributing to the RRSP, the plan sponsor is matching those contributions — to a limit — in the DPSP. "If you were to offer only a DPSP, that means only employers are putting some money in there because employees are not allowed to put money into a DPSP," she says.

"And if the employer contributions go to the RRSP, their contributions are subject to payroll taxes, so they're going to get a deduction for [Canada Pension Plan, employment insurance] and other things. The member then has to claim that amount as a tax deferral when they file their personal taxes and it becomes complicated and muddies the waters when an employer is directing any money into that."

For instance, if a plan sponsor contributes $5,000 through group RRSPs, that amount is considered employee income and attracts payroll taxes, notes Howard Chao, director of the Canadian investment practice at Buck. "So employers will typically try to put employer contributions in a DPSP and less in a group RRSP for that reason. That way the company match avoids the payroll tax in the RRSP."

What IS A DPSP?

A **deferred profit-sharing program** is a Canadian employer-sponsored profit-sharing plan. It's often used in conjunction with other retirement plan options, such as a registered retirement savings plan.

Employees in a DPSP receive a pro-rata portion of the company's profits, which are invested in a tax-free account. The employer contributions are tax deductible and the plan is registered with the Canada Revenue Agency.

Read: Plan sponsors favouring group RRSPs, DPSPs over DC plans

Also, since DPSPs aren't registered with provincial governments, plan sponsors have fewer filing requirements and administration compared to a DC plan, says Tom Mudrinic, principal of Canadian practice wealth consulting at Buck. "But the message we often tell our clients is that, even though it looks to be hands-off, under [the Canadian Association of Pension Supervisory Authorities] guidelines, the sponsor of any kind of [pension] vehicle still has a fiduciary obligation to manage the arrangement in the best interest of employees."

Rahim Peera, chairman of the retirement committee for the Benefits Alliance Group, agrees. "With the clientele we have, we're dealing with more mid- and small-size employers and, for them, pension regulation and governance becomes very time-consuming and difficult with the manpower they have allotted to running their retirement committees. So group RRSP-DPSP arrangements are definitely more flexible and much easier to manage for these plan sponsors."

In terms of investment options, the RRSP-DPSP structure is comparable to a DC plan, says Chao.

Another benefit, especially for small- and medium-sized employers looking at how to retain employees, is the DPSP's two-year vesting period, which can be tied to encouraging staff to stick around, says Peera.

The downsides

But this can also be a downside, says Janice Holman, a principal and leader of the DC and financial wellness practices at Eckler Ltd. Once an employee leaves their employer, the money is no longer locked in. "So if I'm a millennial and I'm going to have 20 jobs in my life, every time I leave an employer, it's just like an RRSP, so I could cash it in. It's not going to be guaranteed that [these plan members] will have retirement income."

Read: Fewer than half of Canadians investing in RRSPs, TFSAs

Indeed, RRSP and DPSP members can withdraw funds for purposes other than retirement, an option that makes some plan sponsors uneasy. "When they get to retirement, either way, that money could be fully cashed in," says Holman, noting this may not be the right retirement vehicle for an employer that wants their employees to have a lifetime income.

"If you are worried about them having a retirement income for life, they might not achieve that because they could cash it all in when they retire and want to go on a big trip, and then get to 75 and run out of money."

Joe Nunes, executive chair of Actuarial Solutions Inc., says he isn't really a fan of the RRSP-DPSP structure as a retirement vehicle. While he acknowledges it can be a useful savings account, he also notes the assets aren't as sticky and don't necessarily go towards retirement income.

As well, he considers the name of the plan misleading — most DPSPs are fixed contribution as opposed to actual profit-sharing plans, where the amount of money each plan member receives is actually tied to their organization's profits.

Fast facts on DPSPS

• Only an employer can contribute to
a DPSP.
• An employer has no requirement to contribute to the plan in years with no profits.
• A DPSP typically complements a group
RRSP.
• Vesting rules are allowed.

Trending up

Whether or not plan sponsors are weighing the pros and cons of the RRSP-DPSP combination, it's the fastest growing plan design for CAPs, says Gilbert. Indeed, the 2019 CAP Suppliers Report found 8,325 Canadian employers are providing DPSPs in 2019, compared to 4,129 in 2009.

It can be considered a continuum for some plan sponsors, says Jillian Kennedy, leader of DC and financial wellness at Mercer Canada. Since many employers started with a DB plan and moved to a DC arrangement, she suggests the growth is just a continued development in plan design.

Read: 2018 CAP Suppliers Report: How to help contract workers save for retirement

"For some, they take a look at how they can reduce the administrative effort and keep up with their workforce and what it wants. Not everyone wants a pension plan . . . and so some will see this as an evolution of design."

In part, Holman believes the savings combination is trending due to its flexibility. "It's common to have the DPSP with an RRSP. Employees understand RRSPs, they're not as complicated as pensions, so it's something they can engage with more easily because they're well understood. Also, for younger people, they can do [first-time] home-buyer withdrawals from an RRSP, so it helps create good savings behaviours."

For Chao's plan sponsor clients, a mixture of all three options is more typical. "A lot of sponsors offer the combination of DC and group RRSP. And for employers that don't want to get into the multi-layered legislation filing requirements of the DC pension plan, they might opt for the group RRSP-DPSP structure."

Sharing success is one way to look at it. At IKEA, the DPSP allows the company to defer profits to employees so they can share in the company's success. Employees are the best ambassadors and "the key to developing our business and delivering strong results," says Newbigging. "That is why it's so important for us to share this success equally through the program."

And by offering it alongside an RRSP, IKEA can help employees save for life after work, she adds. “The program has been set up to show appreciation and gratitude for co-worker loyalty and contribution to the success of IKEA.”

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