Benefits CANADA

Does the pension industry have a language problem?

By: Jennifer Paterson | April 14, 2023 | 08:55

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Defined benefit. Defined contribution. Target benefit. Shared risk. Collective. Multi-employer. Pooled. Canada's pension and retirement landscape is littered with lingo that can often be confusing for the people who participate in these plans and count on them for their retirement income.

As pension plans evolve and the terms describing them expand, does the industry have a language problem?

"I think the language is complicated and it does make it difficult for a layperson to understand pensions," says Joe Nunes, executive chairman at Actuarial Solutions Inc. "With that said, pensions are complicated and that's why the language is complicated. But I don't think . . . we can just simplify the language to make it easier for people because all of this complexity revolves around how complex the various retirement savings programs are."

Read: Editorial: Can the industry move beyond the complexity of pensions?

Adam Rennison, a partner and senior consultant at PBI Actuarial Consultants Ltd., also calls pension terminology unnecessarily complicated, but he notes the names of these plans are just aiming to describe different types of risk. "Maybe as an industry, that risk discussion needs to be a little bit more upfront. Trying to re-label these things to get through what exactly the risk is, that might get complicated. . . . We've just got to be extremely clear to the public and [plan] members about what exactly the risks are."

> **By the numbers**
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> • **6.6M** — The number of Canadians who were active members of registered pension plans in 2020, **up 57,000** from 2019
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> • **4.4M** — The number of Canadians who were covered by a DB plan in 2020, **up 1.7%** from 2019
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> • **18.4%** — The percentage of registered pension plan membership made up of DC plans in 2020, **down 7,300** members since 2019
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> • **952,000** — The number of workers who belonged to plans not classified as conventional DB or DC models in 2020, **down 11,000** members since 2019
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> Source: Statistics Canada, July 2022. Data as at Jan. 1, 2021.

Indeed, when it comes to pension plans, there isn't a one-size-fit-all approach, says Doug Chandler, Canadian retirement research actuary at the Society of Actuaries Research Institute, noting different employment relationships require different types of risk-sharing vehicles. "A pension plan member is only a member of one plan and only has to understand [their plan]. So from the plan member's perspective, [terminology] isn't a problem. The thing to do is to is to get the right deal for that employment relationship and that employee."

Defined benefit, contribution plans

Traditionally, the pension industry — and workplace savings plans, in particular — has been built on two pillars: DB and DC plans.

While most people are familiar with these plans, Statistics Canada defines a DB plan as a type of pension in which a sponsor promises a specified payment, lump-sum or combination of the two upon retirement. The pension amount depends on a member's earnings history, tenure of service and age, rather than on individual investment returns. The sponsor is responsible for managing the plan's investments and risk.

Read: 2019 Top 50 DC Plans Report: What does the future hold for hybrid pension plans?

On the other hand, a DC plan sets out specified contributions made by the sponsor — and the member if the plan is contributory. DC plans allow members to invest pre-tax dollars in stock markets, where those dollars grow tax-deferred until retirement, and the benefits paid are a function of accumulated contributions and investment returns.

Even with these clear definitions, Malcolm Hamilton, a pension expert and senior fellow at the C.D. Howe Institute, says it isn't natural for younger people to have a complete understanding of their pension plan. "How much time can you expect them to spend trying to understand contingent entitlements that may give them money 20 years in the future? The answer is, they don't really.

"It's just overwhelmingly complicated," he adds. "If they devoted weeks to studying it, they really would still be hard-pressed to understand what they're entitled to. . . . It's not important to them because, for the most part, these plans just happen to them."

The Colleges of Applied Arts and Technology pension plan's DBplus is one plan that clearly references the DB model in its name. Before the CAAT launched the plan in 2018, it reached out to industry experts to share the details. "We talked about our funding policy and joint governance, the pooling, the predictability and also providing fixed costs for the employers," says Derek Dobson, president and chief executive officer of the CAAT. "We had a few different names we were testing and DBplus resonated with the industry experts."

While the concept of fixed employer costs may not immediately make people think of a DB pension, Dobson has always called it a pure DB plan with an upside. "The reason I say that is we can't reduce accrued benefits. So members accrue benefits — predictable, secure lifetime retirement income — and we can never reduce that. So that's defined benefit in its core. And when the plan does well, our members do well as well, so we get DB with an upside."

Read: **Pension plan sponsor appetite strong for new innovative design options**

It's a similar story at the OPSEU Pension Trust, which launched its OPTrust Select in 2018 as a separate schedule under the DB umbrella of the parent plan. Jesusa Chow, the organization's vice-president of member experience, says the name of the plan refers to the quality of the plan. "It goes well with 'simple select' — that it's a fairly straightforward plan to understand and that was the goal. The members and the employers have selected us as their pension plan and we handle the rest, so there's that 'simple select' theme happening when the name was determined."

Target-benefit plans

Bita Jenab, a principal at Retirement-Works Services Inc., believes people now understand the difference between a DB and a DC plan.

"We've come a long way. I think it boils down to different types of defined benefit plans, like a target benefit, which is not new. It goes back to the negotiated cost multi-employer plans, where . . . the benefit would be whatever those contributions could buy. So in effect, it just wasn't quite a target benefit. . . . But I think it's very important for people to understand why they have a target-benefit plan, that it's an innovation and it's supposed to bring them sustainability of their benefits, rather than a negative."

A report published in March 2020 by the Canadian Institute of Actuaries and the Society of Actuaries defined target benefit as a collective, pre-funded plan pooling both economic and demographic risks. It has a predefined retirement income goal — the target benefit — where the sponsor's financial liability is limited to predefined contributions while members' benefits may periodically be adjusted upwards or downwards relative to the original target.

Read: **Report finds disconnect between how target-benefit plans are regulated, managed**

Chandler, who wrote the report, says target benefit is a bit of a nebulous term. "That name has been used for different things in different places. The primary use that's emerging in Canada is for what regulators are developing to replace — or very similar to — the old multi-employer pension plans. And the extent to which they're different is to be determined."

Tackling the terms

• **Target benefit** — A collective, pre-funded pension plan pooling both economic and demographic risks, with a predefined retirement income goal — the target benefit — where the sponsor's financial liability is limited to predefined contributions while members' benefits may be adjusted upwards or downwards relative to the original target

• **Collective defined contribution** — A term used to refer to a variation on target-benefit plans pioneered in the Netherlands, with no provision for variations in contributions in response to past service gains and losses

• **Shared risk** — A term introduced by N.B. to describe plans with a high degree of confidence that defined benefits will be paid, restricted variability in contributions and provision for benefit reductions in extreme circumstances

• **Pooled target DB plan or commingled DC plan** — Terms introduced to describe plans in between DB and DC arrangements

Source: Canadian Institute of Actuaries and Society of Actuaries report, March 2020

The defining characteristics of a target-benefit plan is that most of the risk goes into the benefit, says Hamilton, noting the plan sponsor and plan members each have a fixed contribution.

"At the end of the day, the risk then finds its way into the benefits, so if you were a member of that plan, you [wouldn't] want somebody to tell you your benefit is variable [or] this is a target. You'd say, 'Well, how close to the target should I expect to get?"

Shared-risk, jointly sponsored plans

The shared-risk model first gained prominence in Canada a decade ago when New Brunswick introduced it for the province's public sector pension plans.

Developed through a consultation process and based on a Dutch model, the approach combines elements of both DB and DC plans, with the risks shared between the plan sponsor and members. The model promises a basic benefit that may increase or decrease depending on the plan's performance. In addition, if the plan performs well, contributions could drop and benefits paid could rise. On the other hand, if the plan performs poorly, contribution levels could increase and benefits could be reduced or suspended.

Read: Are New Brunswick's shared-risk plans on target?

New Brunswick essentially owns the shared-risk label, says Chandler, though he classified it with jointly sponsored plans in his 2020 report on the basis of the way it's treated under accounting and tax rules.

Jenab calls British Columbia's public sector plans the pioneers of shared-risk plans. Twenty-five years ago, the four plans — the Colleges Pension Plan, the Municipal Pension Plan, the Public Service Pension Plan and the Teachers' Pension Plan — went through a process called jointly trusteed with the B.C. government as the sponsor, she says, noting the provincial government would appoint plan member and sponsor trustees to the pension boards.

"At that point, it was coded in the legislation that any gains or losses are shared equally between plan members and employers. That gave rise to the concept of sharing of risks. I think the most prudent structure is that, if it is a shared-risk plan, it also has joint governance. They should go hand in hand."

For shared-risk plans, Nunes says the label implies the story, though who's sharing the risk and what risk they're sharing is often unclear. "I don't think the problem there is the name of the plan. I think the challenge is . . . trying to explain what risks are being shared, what parties are sharing those risks and spell that out. . . . And so, I don't think the name of the plan is a huge distraction."

Collective, multi-employer plans

Collective pension plans, which emerged in the U.K., are most like Canadian multi-employer plans.

"But like the target-benefit rules that are emerging in Alberta and B.C., it doesn't have to be multi-employer," says Chandler. "It can be single employer."

Read: The Royal Mail Group's road to offering U.K. employees a collective DC plan

At PBI Actuarial, almost all of Rennison's clients are multi-employer pension plan sponsors. However, one of these plans was recently converted to a target-benefit plan. "At the end of the day, there was really no change in the process. [With] these multi-employer DB plans, you could still cut benefits. It was just the mechanism of that — you had to apply to the regulator to cut benefits if you didn't have enough contributions coming in from the collective agreement.

"But when we talked to members about this change, they were under the impression that, 'No, we have this benefit, there's no way we can ever have a cut from that.' Communications is the best way to get at it. I don't think changing the terminology or the labels [is the answer]. I think it's a financial literacy issue."

Let's talk about pensions

Indeed, Rennison says the pension industry can communicate until it's blue in the face, but it needs to have a receptive audience.

"I'm an actuary. I get it. We use a lot of acronyms. We use a lot of these terms. This is complicated stuff."

As well, he notes the cost of communications is low compared to any legal issues a pension plan sponsor may encounter down the road, but he acknowledges some employers may not have the budget for it and there could be an issue with communicating too much. "There's a balancing act there and I think it keeps coming back to, if you're not financially literate, you're less likely to read that stuff and [more likely to] just chuck it away."

Andrea Boctor, a partner in the pension and benefits group at Osler Hoskin Harcourt LLP, agrees that good communications is a balancing act. "Simplifying all of these concepts would make it a lot easier, but then, when you simplify things too much, the nuance you're trying to convey can get lost. So it's a balance we're trying to strike."

Read: Head to head: Will the government's super-priority bill spell the end of DB pension plans?

One example of miscommunication in the pension industry, she adds, is the way it traditionally talked about the DB guarantee — now reflected in the introduction of Bill C-228, which proposes giving super-priority to plan members. "Maybe we could have done a better job of communicating that guarantee. But at the same time, if your pension is cut in an insolvency, the fact that you were told it could happen wouldn't make you feel any better about it."

> **Key takeaways**
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> • Pensions are complicated so the language used to describe them is often complex, but this terminology is just aiming to describe different types of risk.
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> • Using simple and straightforward communications to share the details of a pension plan is a key part of driving the value proposition of the plan.

> • Correct and clear communications is also an important part of avoiding legal issues.

Chandler agrees. "Looking back, that's something that maybe we didn't get quite right — that plans that were never intended to be fully guaranteed somehow slipped into becoming fully guaranteed because of communications issues."

For the CAAT and its DBplus plan, communications is huge and drives the value proposition. "Let's face it, at the end of the day, what we're trying to do is deliver what members are asking for and what employers can afford, so you need to meet them where they are," says Dobson. "The communication program is very simple [and] straightforward."

The OPTrust Select team also aims to ensure its communications is simple, says Chow. "There are certain things that we are legislatively required to say and explain, so we do our best to really focus on simple language."

Potential legal risks

Speaking of legislative requirements, any communications misstep has the potential to lead to legal issues for pension plan sponsors.

"In an increasingly litigious society, employees are more likely to say, 'Well, that's not what you told me, that's not what you said,' and complain, at a minimum, and at a higher level, potentially launch litigation," says Nunes. "And so, as a result, all of us actuaries and lawyers that are working behind the scenes in this business go through painstaking efforts to make sure we use the technically correct language and that we clearly communicate."

Read: A look at how the legal landscape for DC pension plans is changing

Indeed, if a plan sponsor doesn't properly communicate the terms of its plan, it can run into all types of legal issues. "You could have employees take you to task by trying to enforce the terms that, for example, are in a booklet that don't match the plan terms," says Boctor. ". . . Ideally, communications about the plan line up with the actual plan terms."

Adding to the legislative and regulatory complexity, Canada has different types of pension plans in different jurisdictions. "Right now, we've got so many different innovations happening across the country that we do need all of these terms," she says.

"But eventually, my hope is that, as an industry, we coalesce around the strongest performers and pull the best features from the plans we like and have more standardized options across Canada."

Jennifer Paterson is the editor of Benefits Canada*.*