Dynamic pensions hold the promise to provide retirement security

Running out of savings is a common concern for Canadians leaving the workforce. There may soon be a new financial tool to help address it.

Dynamic pension plans or variable payment life annuities (VPLA) are on the horizon, following recent changes to federal legislation. They'll be available from pension plan sponsors, insurers and other financial institutions across Canada.

Only about one in four Canadian workers have a defined benefit (DB) plan, and that percentage is declining annually, according to Statistics Canada. For many retirees, their best option for generating income for life is an annuity, which involves trading off a large sum of retirement savings in return for a guaranteed stream of money.

Like a defined benefit pension, dynamic pensions offer that regular income. They also allow for a plan member's capital to be partially invested in the stock market. That provides the opportunity for payments to increase over time, unlike an annuity. Payments will fluctuate depending on the performance of the underlying assets.

"The value of dynamic pensions is they give retiring Canadians a decumulation option that looks like a defined benefit pension, where running out of money is no longer a risk," says Bonnie-Jeanne MacDonald, director of financial security research for the National Institute on Ageing (NIA) at Toronto Metropolitan University.

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Dynamic pensions offer the benefit of scale by pooling retirees' capital. That lowers the investment fees people would otherwise pay to manage capital accumulated in a workplace plan on their own, or with an adviser in a life income fund (LIF) or registered retirement income fund (RRIF).

Life's brighter under the sun

Sun Life

MacDonald says dynamic pensions will appeal to members of workplace defined contribution (DC) plans and group RRSPs, which are most widely offered in the private sector.

The NIA and the Global Risk Institute have released a report on how dynamic pensions can serve as an efficient decumulation tool. "The lack of an acceptable option to convert retirement savings into affordable monthly lifetime income is creating a dangerous disconnect in the Canadian retirement income system, and there is widespread concern this will lead to increasing financial insecurity for a large portion of the population," the report states.

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More widespread availability needed

Despite their potential, dynamic pensions won't be widely available yet, says Eric Monteiro, senior vice-president of group retirement services at Sun Life. Current federal legislation enables only members within a specific DC plan or pooled registered pension plan (PRPP) to choose dynamic pools as an option. "Based on the makeup of most DC plans, only a handful would be large enough to offer an in-plan dynamic pension solution effectively," Monteiro says.

Monteiro explains that many plan sponsors are too small. They don't have enough retiring members to run a dynamic plan efficiently. In addition, PRPPs are not broadly utilized and therefore also lack the necessary scale.

Legislation would need to be amended to allow dynamic plans to be offered to Canadian workers across multiple DC plans, group RRSPs, and even to those who aren't part of any workplace pension, MacDonald adds. "The big point here is that dynamic pension plans should be available to everybody."

Such a change would allow these plans to have sufficient scale and provide many workplace plan members with superior income security in old age. Dynamic pensions could also provide that same benefit to the six out of 10 Canadians without a workplace pension.

Either way, late-retirement income security is needed more than ever, MacDonald says. "There's a common myth about retirement that people require less income as they age."

Even if people spend less in general as they get older, elder care costs are expected to grow rapidly in the future. And aging Canadians can't necessarily rely on their adult children to provide this care. The baby boomers "are not only likely the generation to live the longest, they're also the first to have fewer children," MacDonald says.

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Consequently, as boomers enter their 80s, they are more likely to have to pay for care to age in place or for assisted living and long-term care. MacDonald points to research forecasting that long-term care costs will triple in 30 years to about $71-billion. "It's going to cost a lot more money, adding stress on retirees."

Dynamic pensions are a viable option to address those rising costs. Despite not being offered widely in Canada, these products are not entirely new. The University of British Columbia (UBC) has offered a VPLA option for its pension plan members since the late 1960s. It has been so successful that the model was recently emulated by an Australian state-sponsored pension plan.

“There’s a certain irony that another country has copied this and in Canada we’re not allowed to offer it more easily,” MacDonald says.

Additional provincial legislation is required before VPLAs can go into effect. In the meantime, Sun Life continues to advocate for government to create better access to dynamic pensions for Canadian workers with all types of retirement savings.

“Sun Life envisions that VPLAs will become a choice for all retiring Canadians—pension plan members or not—to provide an income stream for life and peace of mind in retirement,” Monteiro says.

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