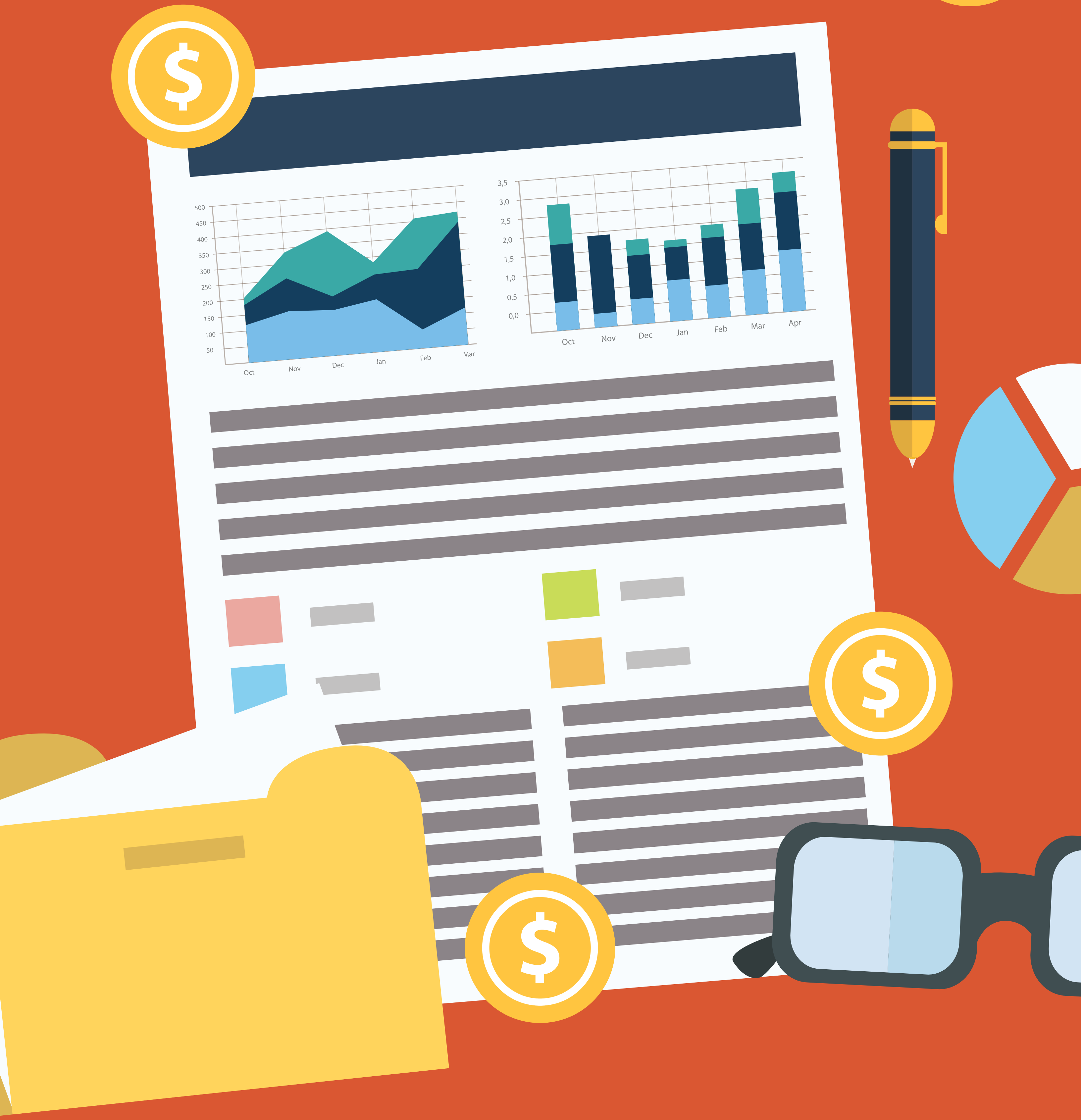
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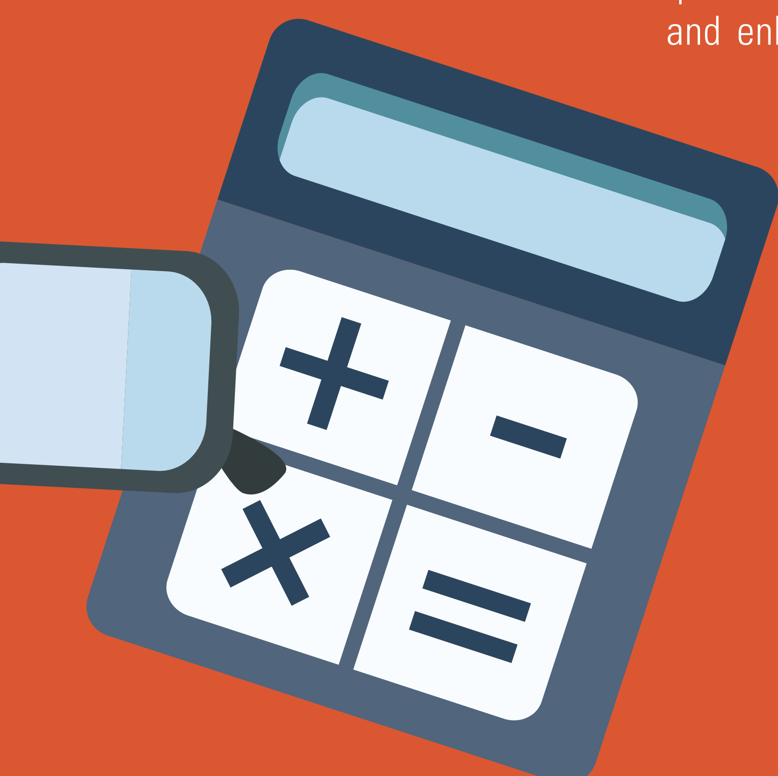
Decumulation in Retirement:

Are Variable Benefits the Right Solution for Your DC Plan?

by | **Tyler Smith** and **Susan Watson**

Most provinces allow defined contribution pension plans to offer *variable benefits*, which provide a way for plan members to start drawing a retirement income without having to transfer their assets out of the plan when they retire. Variable benefits add some administrative complexity and cost for plan sponsors, but they also offer potential advantages such as reduced investment fees and enhanced professional oversight for members as well as the ability to help support members through retirement.



Earlier this year, Ontario officially enacted legislation to allow variable benefits to be paid from defined contribution (DC) pension plans. Ontario follows a number of other jurisdictions in permitting variable benefit payments as regulators look to expand the options available to DC plan members when they reach the decumulation stage of their lives. Flexible payment schemes such as variable benefits have become more common across Canada over the past decade. These arrangements add complexity to pension plan administration, but trustees should assess whether they can add greater value and flexibility for their membership.

When Variable Benefit Legislation Was Enacted Across Canada

British Columbia	2004
Federal (Income Tax Act)	2005
Alberta and Saskatchewan	2006
Manitoba	2007
Nova Scotia	2015
Federal (Pension Benefits Standards Act)	2015
Quebec	2018
Ontario	2020

What Are Variable Benefits?

Variable benefits provide a way for plan members to start drawing retirement income from a DC pension plan without having to transfer their assets out of the plan when they retire. A simple way to think of variable benefits is that they work much like a Life Income Fund (LIF) or a Registered Retirement Income Fund (RRIF), where a member makes annual or monthly withdrawals to provide them with retirement income. With variable benefits, retirement funds are paid directly from the pension plan instead of from a financial institution or insurance company. Similar to LIFs and RRIFs, members must take out a minimum amount each year and are subject to a maximum amount that can be withdrawn.

The History of Variable Benefits in Canada

Variable benefits have actually been around for more than 15 years in Canada. British Columbia was the first province to introduce variable benefits back in 2004, and Alberta, Saskatchewan and Manitoba quickly followed. Quebec, Nova Scotia and the federal Pension Benefits Standards Act have all added variable benefit legislation within the last five years, with Ontario being the most recent province to allow for variable benefits. At this time, only New Brunswick and Newfoundland and Labrador have not implemented variable benefit legislation. Variable benefits are currently only available to registered pension plans; therefore, plans such as Group Registered Retirement Savings Plans (RRSPs) cannot offer them.

How Do Variable Benefits Actually Work?

Variable benefits are a choice that a member makes at retirement, no different than electing to transfer their DC assets to LIFs or RRIFs. If a member elects to commence a variable benefit, they always have the option to transfer their assets to another retirement vehicle at a later date (i.e., the member is not locked into remaining in the variable benefit if they change their mind and feel it isn't the right retirement income vehicle for them).

Plan members interested in the variable benefit option would coordinate their annual or monthly withdrawals with the plan administrator, similar to how they would request withdrawals from their financial institution. For the plan administrator, permitting variable benefits requires more oversight. It also requires more work to ensure that variable benefits are being drawn down within the applicable legislative limits.

Do Variable Benefits Provide Any Advantages?

There are a number of reasons trustees and plan sponsors may wish to consider adding variable benefits as an option for plan members.

Reduced investment fees for members: By using variable benefits, plan members can take advantage of the lower investment management fees of the pension plan, compared with the cost of using retail funds from a financial institution. The savings in fees, which can add up to 1% to 2% a year, can translate to higher annual income for the retired member or extend the life of their retirement savings by a couple of years.

Professional oversight of investments: In addition to lower investment management fees, members can benefit from the professional oversight of their assets. Most plans generally employ an investment consultant to provide advice, monitor the investment performance of plan funds and provide a streamlined set of investment options for members to choose from. For allocated plans where members do not have choices, variable benefits can allow retirees to participate in alternative and real asset class investment such as real estate or infrastructure as part of a larger fund that they could not access on their own.

Extended relationships with the union: For union plans or plan sponsors with a more paternalistic view of supporting the member through retirement, variable benefits are another way that allows members to stay connected to the organization by keeping their money in the pension plan. Maintaining this connection also serves as a potential opportunity to provide ongoing financial education and support through a member's retirement.

If a member also has postretirement benefit coverage through their organization, opting for a variable benefit with the same organization can make it easier to manage their finance and health benefits by potentially having a single point of contact instead of dealing with multiple entities.

Are There Any Risks or Challenges?

Despite the advantages of variable benefits, plans must consider a few potential drawbacks before moving forward with this option.

Equity among members: While many jurisdictions have enacted variable benefit legislation, there are still some provinces that do not permit variable benefits. For plans with members in multiple provinces, this means that some members may not be able to access the variable benefit option. For example, if a plan covers members across the Maritime provinces, variable benefits would not be accessible for members in New Brunswick.

Additional administrative complexity and cost: Traditionally, when DC members retired, they transferred their assets out of the plan, and there was little need to continue to maintain records and up-to-date information for these members. By incorporating variable benefits, DC plans will operate more like defined benefit plans, where records and addresses must be kept up to date to ensure proper communication. As well, ensuring that the variable benefit payments fall within the legislative minimum and maximum annual withdrawals would be required as part of the ongoing administration. As a result, there is some increase in the cost to administer the plan. Trustees and plan sponsors must consider their fiduciary risk in providing variable benefits from the plan and ensuring that their administration systems are capable of maintaining proper recordkeeping.

The Member Experience With Variable Benefits

Plans that have implemented the variable benefit retirement option have seen many plan members embrace it and value its simplicity and flexibility. Members seem to appreciate having some control over their retirement benefits. In considering the variable benefit option, there are a number of common and frequently asked questions that administrators, plan sponsors and trustees should be prepared to answer.

"What are my investment options?" Typically, a member selecting the variable benefit option can continue to participate in the same investment funds in retirement as they did throughout the accumulation phase. Investments can be as simple as the same investment portfolio as the overall DC pension plan or, alternatively, the plan can offer options for the member to select their

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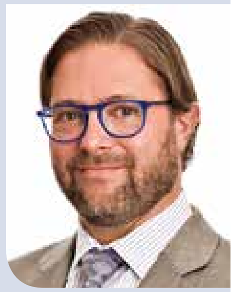

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own investment direction from predetermined investments such as asset allocation funds, specialty funds, etc.

One aspect that trustees will need to consider is the level of investment risk they want to offer in the funds provided to retirees. Because retirees are in the decumulation stage of their careers, their ability to absorb a correction in the stock markets is much lower than that of active plan members.

"How much will I receive from my pension?" Variable benefits allow plan members to change their payments as needed, provided the payments fall within the minimum (per the Income Tax Act) and maximum withdrawal requirements (where applicable, per the provincial Pension Benefits Act).

Minimum withdrawals are not required until age 72 and, after the age of 72, the minimum is determined according to the minimum withdrawal formula for RRIFs under the Income Tax Act. With variable benefits, plan members will need to be advised on what their payment range is each year. Having conversations with retirees just before or early in the new year about the range of income they can choose to receive can greatly assist them in planning for their income needs.

"Is my variable benefit pension taxable?" Variable benefit pension accounts are tax-sheltered and tax-deferred until withdrawals/payments are made. Withholding tax is required on all payments, and administrators will need to ensure that a T4A is reported to the Canada Revenue Agency on behalf of members, indicating a member's withdrawals and income tax paid for the calendar year.

When members turn age 65, variable benefit income qualifies for the $2,000 pension income tax credit as well as income splitting with a spouse (provided both member and spouse are age 65 or older). As with any other source of pension or retirement income, retirees must consider all other sources of income they are receiving in retirement and may need to adjust the withholding tax or set aside money for any additional taxes that may result when looking at their total income.

"Can I add funds to my variable benefit account?" It is possible to transfer registered retirement money into a variable benefit account; however, the type of eligible funds is dependent on the applicable provincial pension legislation and specified pension plan provisions.

"What happens to my variable benefit account upon

death?" This is an important topic for retirees; however, prospective variable benefit members are usually relieved to find out that the death benefit is their variable benefit account balance, which is payable to their beneficiary upon death.

If a spouse is a *specified beneficiary*, he/she may choose to stay in the pension plan and continue receiving a variable benefit payment, purchase an annuity with the account balance or transfer the balance to another registered account (according to the applicable provincial Pension Benefits Act). If the member's spouse is not listed as a specified beneficiary, the spouse will not be able to continue the variable benefits—Payments would cease upon the member's death, and the balance of the account would be paid out to the beneficiary, subject to withholding tax.

Takeaways

- Ontario is the latest province to allow defined contribution pension plans to offer *variable benefits*, which provide a way for plan members to start drawing a retirement income without having to transfer their assets out of the plan when they retire. At this time, only New Brunswick and Newfoundland and Labrador have not implemented variable benefit legislation.
- Variable benefits are similar to a Life Income Fund (LIF) or a Registered Retirement Income Fund (RRIF), where a member makes annual or monthly withdrawals in retirement. Similar to LIFs and RRIFs, members must take out a minimum amount each year and are subject to a maximum withdrawal amount.
- Variable benefits are a choice that members make at retirement. If members elect to commence a variable benefit, they always have the option of transferring their assets to another retirement vehicle at a later date.
- Risks and challenges include equity among members since there are some provinces that do not permit variable benefits, additional administrative complexity and cost. Trustees and plan sponsors must consider their fiduciary risk in providing variable benefits from the plan and ensuring that their administration systems are capable of maintaining proper recordkeeping.
- Advantages of variable benefits include reduced investment fees for members when compared with retail funds from a financial institution; professional oversight of investments (since most plans have an investment consultant that monitors investment performance and streamlines investment options); and the ability for plan sponsors to support members through retirement, potentially with financial education and support.

Conclusion

Variable benefits can be a useful instrument to provide expanded options to members in the decumulation stage of their lives, but each plan must consider whether variable benefits are right for them, based on their circumstances. For trustees and plan sponsors, the decision must determine whether the benefits for plan members are significant enough to offset the additional administrative complexity that can come with variable benefits. For plan members, the savings through lower fees and overall flexibility of choice in how to use their retirement income can be a valuable tool when combined with their other sources of retirement income to strengthen their overall financial wellness.

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