Appendix 1: Glossary

The Task Force developed a pensions glossary which can be found online here. For the purpose of this report, it is helpful to understand the following pension plan types:

DEFINED BENEFIT (DB) PENSION PLAN
A DB plan aims to provide you with a lifetime retirement income. You can know in advance how much income you will receive after you retire (until death) based on a formula that takes into account how long you contributed and how much you earned. Employers and workers contribute a set percentage of salary. Funds are invested by a professional. **Longevity risk** (how long you will live) is shared across a group of members (or even multiple workplaces) so that no one runs the risk of outliving their savings. In most DB plans, an employer (or group of employers) bears the **market risk** (so they have to make up a shortfall if investments do not perform well), while the workers' contributions are fixed.

DEFINED CONTRIBUTION (DC) PLAN
A defined contribution (DC) pension plan helps workers accumulate retirement savings. Employers and workers contribute a set percentage of their salaries. Funds are held in a personal account for each worker. Individuals decide how their money is invested, usually chosen from a range of options. The cost of a DC plan to employers and workers can be known in advance. However, the worker's retirement income varies depending on how the investments perform and it is not certain the income will last for life.

Arthurs points out that there are specific design features of both DB and DC plan types that are worth considering and combining. This is what led the ONN Pensions Task Force to choose a target-benefit plan, which attempts to provide the best of both worlds. The following is paraphrased from the Arthurs Report:

- In DC plans, the investment risk (risk of investments not performing as well as expected) is borne by individual plan members; in DB plans, it is borne by the employer and/or spread across the plan membership which may include multiple workplaces.

- In DC plans, the longevity risk (risk of living a long time) is generally borne by individual plan members; in DB plans, it is spread across the entire present and future membership of the plan. That's why individuals with DC plans (including Group or individual RRSPs) must plan for their savings to last them to age 90 while DB plans can use average lifespans to determine benefit levels.

- In DC plans, the individual account format leaves little room for insolvency risk (there is no promised benefit, so no measurable "shortfall"); in DB plans, members — particularly of single-employer plans — do bear the risk that a sponsor may fail (i.e., go out of business or stop paying benefits) with an under-funded plan.

- In DC plans, if members leave, their entitlements can be easily calculated and transferred to another plan or a locked-in account (an RRSP account that you may not access until retirement age); in DB plans, individual entitlements are difficult to calculate and more difficult to transfer.

- In DC plans, members end up with a range of options around investment decisions, including making their own; in DB plans these are made by professional advisors. Arthurs notes this point is not trivial. A U.S. study showed that from 1995 to 2006, the investment performance of DB plans, on average, exceeded that of DC plans by 1% a year; over the 11 years under study, the cumulative effect was a 14% advantage in favour of DB plans (Arthurs, 179).

Based on that analysis, Arthurs concludes that “the key advantage of DB over DC plans is the greater capacity of the former to insulate individual workers from risk. In DB plans, the investment risk is, to some extent, transferred from the members to the employer, while the longevity risk is spread across the entire present and future membership of the plan — the larger the membership, the more efficiently managed is the risk.”

He concludes: “Risk-sharing makes the difference, and size allows risk-sharing and other efficiencies to work better” (Arthurs, 180).

TARGET BENEFIT (TB) PLAN

A TB plan pools longevity risk but market risk is borne to some degree by individual plan members. Benefits may be reduced if the funding level falls below a given threshold—or increased if it exceeds expectations. To avoid a reduction, TB plans are governed by more formal funding and benefit policies than typically found in defined benefit plans. In addition, cautious assumptions can be used in the setting of the target benefit with benefit improvements granted only if there is a significant funding surplus. This more conservative approach means less generous benefit payouts than in a comparable DB plan but the pooling of longevity risk means individuals do not risk outliving their retirement income.

Beyond these basic types which simply identify contribution/benefit structures, there are a number of plan types which take into account the importance of governance structures. The following descriptions are taken from the Arthurs Report:

Jointly Sponsored Pension Plan (JSPP): *JSPPs are defined-benefit plans in which the employer or employer representatives and the members [i.e., employees] share responsibility for its funding and governance. JSPPs may be either multi- or single-employer pension plans.*

Multi-Employer Pension Plan (MEPP): *MEPPs are pension plans covering workers employed by a number of employers, usually in the same economic sector. MEPPs are typically target benefit plans. They are customarily funded by fixed contributions; in the event these contributions are insufficient to pay for the benefits provided, the benefits may have to be reduced. MEPPs are administered by boards of trustees at least 50% of whom must represent the active members of the plan. MEPPs in which funding and governance are both shared with the members may qualify as JSPPs.*

Member-Funded Pension Plans (MFPP): *"A new defined benefit plan design developed in Quebec — contemplates that, as in a DC plan or an Ontario-style MEPP, the sponsor's obligation will be limited to the contribution of a fixed amount. Whatever additional funds are required to pay the promised benefits will be contributed by the members who thus collectively assume the financial risk"* (Arthurs, 182).

MFPPs are defined benefit plans where the risk of a shortfall is borne by workers as a collective. Like target benefit plans, employers in member-funded plans pay fixed contributions. Workers also pay into the plan. Whatever additional funds are required to pay the promised benefits will be contributed by the members who thus collectively assume the financial risk. Given the limited capacity of workers to do so, however, these plans are subject to very strict funding rules that effectively require them to be fully funded at all times. Arthurs states that MFPP governance structures are carefully prescribed and they must be embedded in a collective bargaining relationship. The Quebec nonprofit sector's plan, however, includes both union and non-union workplaces because of new Quebec regulations that went into effect in 2007. To do so in Ontario would likely require regulatory and possibly legislative change.

***Jointly-Governed Target Benefit Pension Plans (JGTBPP)*:** This is an ideal type that is proposed in the Arthurs Report. "*These proposed new plans will resemble MEPPs in that they will offer target benefits, and will resemble JSPPs in the sense that they will be jointly governed with enhanced capacity to adjust benefits and contributions. Accordingly, they should be funded in a similar fashion to MEPPs and JSPPs…..*

"Plan sponsors should be permitted to enter into an agreement with a union or similar representative organization to establish a jointly governed pension plan that will provide target benefits. Such plans should be governed by a board on which active and retired members hold not less than 50% of the seats, and should be subject to the same […] funding as JSPPs and MEPPs" (Arthurs, 72).