

Supplemental plans

There is a compelling need for supplemental employee retirement plans. Let's make sure we build them right.

By Glorianne Stromberg

THERE IS NOW ALMOST UNIVERSAL RECOGNITION THAT THE move to defined contribution (DC) plans has not necessarily resulted in better pension arrangements. Instead, DC plans have presented sponsors and members with a whole new set of problems.

The good news is that the focus on these problems has increased awareness of plan members regarding the importance of pension arrangements and how they impact on providing for lifetime self-sufficiency. In other words, there is a new appreciation of the need to understand deferred compensation arrangements. With it has come a sharper focus on appropriate enhancement negotiations and the importance of plan design in terms of

meeting the pension promise.

The success of a DC plan is measured in terms of the value provided to plan members. That is now globally recognized, according to Mercer Human Resource Consulting's 2002 Global Defined Contribution Survey. Unfortunately, there are factors affecting almost every aspect of these DC plans—plan design, investment structure, recordkeeping, communication (including member education), compliance and governance—that detract from plan member value.

The willingness to recognize and deal with these factors coincides with a renewed focus on the controversial defined benefit (DB) plan surplus issue. The surplus debate gained new steam at the end of 2002 when Ontario's provincial government included (and then later reneged on) proposals in Bill 198.

Clearly, this is a complex time for pension plan sponsors. But there is opportunity in this complicated environment to address fundamental questions. What is the best way to provide deferred compensation arrangements? What is the best way to fund them? And what is the best way to encourage capital formation by plan members?

SUPPLEMENTAL PLANS

It is likely that supplemental employee retirement plans (SERPs) will play an increasingly important role, in

large part because the need to provide replacement income continues to outpace limits set for tax-assisted plans. Mark Campbell, a principal with Towers Perrin in Calgary predicts that by 2010 virtually all employers (including DC plan sponsors) will be forced to sponsor a SERP in order to fulfill their pension promises.

Traditionally, SERPs were only provided for key executives. This is changing to encompass a broader range of employees who are highly paid, or whose compensation spikes late in their careers without a comparable increase in their DC account balances. They're also used to facilitate early retirement.

SERPs can be utilized as incentives to attract Americans to Canada or to keep Canadians in Canada. They're a useful tool when making mid- or late-career hires. They help retain talented, experienced employees. And they fill pension gaps such as those resulting from low limits on the accrual of foreign service.

But for all their advantages, there is a need to pay careful attention to plan design, funding and how SERPs are secured. Take a close look at the modification and termination of SERPs, settlement options and costs. Watch plan documentation, plan administration, recordkeeping, communication and governance. This is the time to do it. There are lessons to be learned from DB and DC problems of the past.

Private sector initiative will attempt to fill the gap between tax-assisted pension and retirement benefits and what people actually need in retirement. But a government framework is also needed that will ensure the system fosters this accumulation of capital and that workers' SERPs are adequately secured.

The issues are complex and should not have to be negotiated on a case-by-case basis. Few plan members understand the issues, or how to evaluate the adequacy of the arrangements made. Some plan sponsors are in a similar position. It is important to address the fundamentals before a whole new set of problems emerge that undermine people's ability to achieve lifetime self-sufficiency.

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