Defined Contribution Pension Plans: Did You Know?

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Retirement Basics: What Is a Defined Contribution Pension Plan?

A Defined Contribution Pension Plan

Your employer or union may set up a defined contribution pension plan (DC pension plan) to assist you in retirement. It often looks like an investment account but has certain tax benefits and additional protections. Typically, you and your employer contribute a set amount through payroll deductions to your account in the plan.[1] That's the "defined contribution." Your account grows with contributions and investment returns over time. At retirement, your account balance becomes available to provide you with income.

Defined Contribution vs Defined Benefit Plans

A DC pension plan is different than a "defined benefit" plan as it is not designed to provide a specific income at retirement. Rather, your retirement income depends on the contributions made and the "net" (after fees) investment income earned.

Making Key Decisions

A DC pension plan can be a powerful tool to help you save for your retirement. Your retirement income depends on the choices you make as a plan member. We want to help you make informed decisions today for tomorrow.

Learn and Act Now!

Take action today! This Guide can help you build the income you will need in retirement.

Defined Contribution Pension Plan:
Your income at retirement depends on you! The amount you contribute, the investment decisions that you may make and how you choose to withdraw your money at retirement.

Defined Benefit Pension Plan:
Designed to provide a specific income during retirement. Most decisions are made by the plan.

[1] Not all DC plans require you to contribute. Sometimes only your employer contributes. For unionized employees the amount to be contributed may be set out in a collective agreement.

Retirement Basics: How Do I Save for Retirement?

Your income in retirement can come from many sources. These include government programs like the Canada Pension Plan/Quebec Pension Plan (CPP/QPP), Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). The amount provided by these programs can vary depending on your family status, your other income, and how long you have been living and working in Canada. Retirement income sources may also include workplace savings plans and individual savings. Retirement income calculators can help you figure out how all these sources come together.

Many people rely on all three of these sources of income at retirement (i.e., government programs, workplace savings plans and individual savings). If you have access to a workplace savings plan you may want to take advantage of it!

The following is just one example of how government sources can combine with a workplace savings plan to create a retirement income:

*Note: Income from Government Sources is based on average CPP and OAS amounts for Canadians receiving benefits as reported in the CPP and Old Age OAS Annual Statistics Tables as of March 31, 2020.

This Guide focuses on one type of workplace savings plan: a DC pension plan. We encourage you to speak with a financial advisor to review your personal situation. Financial advisor services are sometimes provided as part of a DC pension plan, by an employer or union or through an employee assistance plan (EAP).

Retirement Basics: What are some DC pension plan Features and Benefits?

- **Tax Benefits:** for most Canadians, as contributions and investment income are not taxable until you withdraw money at retirement.[2]

- **Employer Contributions:** to help you grow your savings faster.

- **Lower Fees:** compared to what you could typically obtain in a retail retirement savings product, such as an individual Registered Retirement Savings Plan (RRSP) at your bank.

- **Investment Options:** professionally-managed investment options.

- **Payroll Deductions:** easy and automatic payroll deductions to help you save.

- **Legal Standards:** laws and a pension regulator that require the plan to meet certain standards.

- **Held in Trust:** pension amounts held separately in trust for your retirement.

- **Safety from Creditors:** to preserve your DC pension plan account balance for your retirement years.

- **Disclosure Requirements:** to provide certain information to you.

[2] Indigenous peoples may be eligible for the tax exemption under section 87 of the Indian Act.

The following sections explain important facts about DC pension plans and retirement income through the use of examples.*

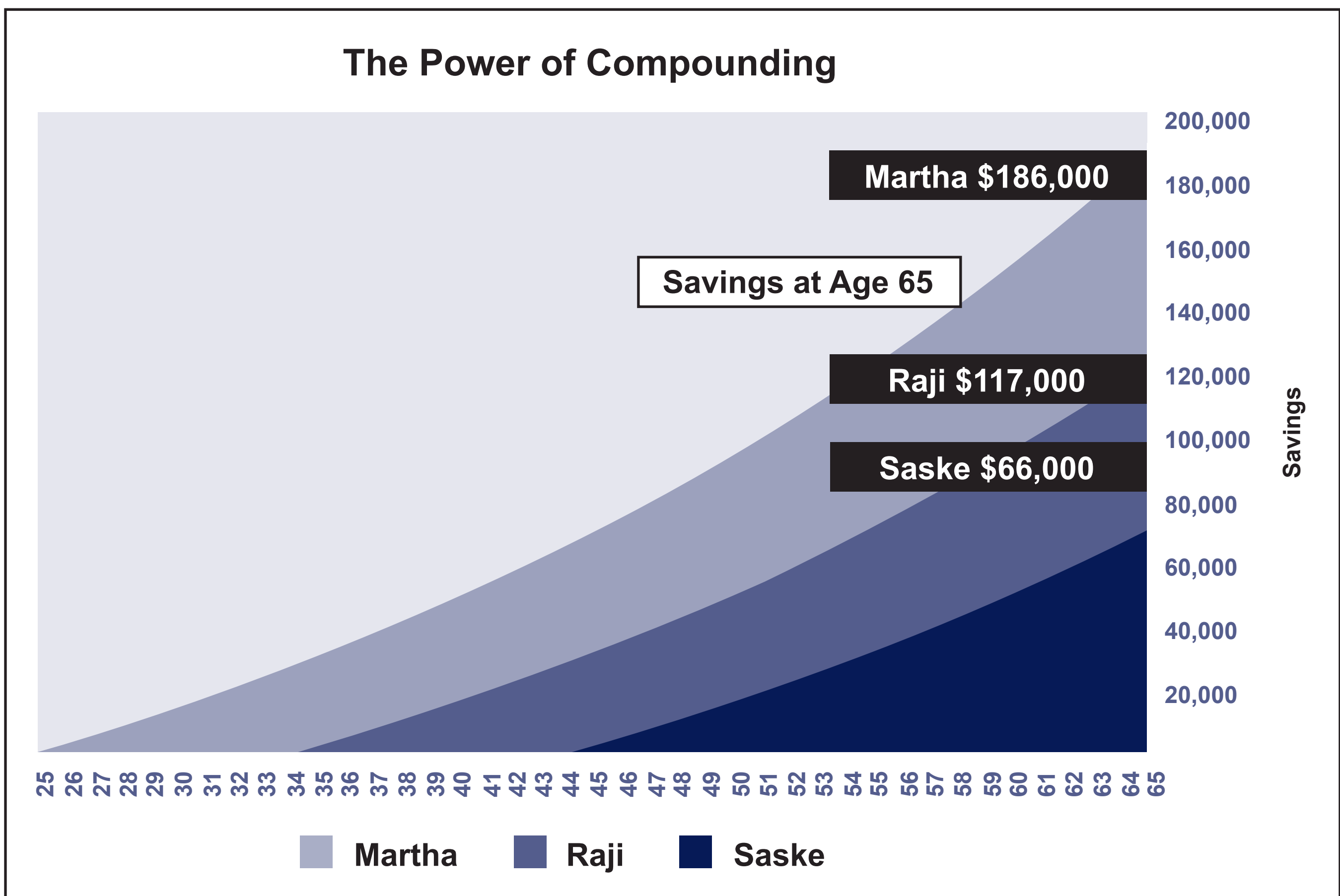
Follow Martha, and others, as they navigate their DC pension plan. Notice that Martha's decisions dramatically impact the income Martha's DC pension plan provides on retirement.

*Note: The examples presented are for illustrative purposes only and depend on the assumptions that have been made such as contribution rates, investment returns and savings period. They may not reflect real world experience.

Enrolling Today Can Increase Your Savings

If you have the option to enroll in a DC pension plan you should consider it. Statistics show that 3 in 10 Canadians are not preparing financially for retirement.[3] Enrolling early is one of the best things you can do to increase your savings during your working years. The impact of saving early can be very significant.

Compounding is the reason why people benefit from starting to save as soon as possible. Compounding means you earn investment returns on your initial savings, plus investment returns on the returns your original savings generate over time.



[3] Financial Consumer Agency of Canada, Key Findings from the 2019 Canadian Financial Capability Survey.

Consider Martha, who was enrolled in the DC pension plan and started saving at age 25. At retirement, Martha's DC pension plan savings provides an estimated monthly income of $940 - almost triple that of Saske who started saving at age 45.

Martha

Martha enrolls in the DC pension plan at **25 years old.**

At retirement, Martha's DC savings ($186,000) can provide an estimated lifetime income of **$940 per month.**

Raji

Raji enrolls in the DC pension plan at **35 years old.**

At retirement, Raji's DC savings ($117,000) can provide an estimated lifetime income of **$590 per month.**

Saske

Saske enrolls in the DC pension plan at **45 years old.**

At retirement, Saske's DC savings ($66,000) can provide an estimated lifetime income of **$333 per month.**

How Did They Get There?

Average Annual Net Return: 3%

Monthly Employee contributions: $100

Monthly Employer contributions: $100

Age at Retirement: 65

Note: The amounts that Martha, Raji, and Saske receive from their DC plan are in addition to any other income sources they may receive in retirement. These could include CPP / QPP, OAS, GIS, or income from other personal savings (e.g., individual RRSP, prior pension plan, personal investments, etc.).

Note: All examples are based on an assumption of typical life expectancies and do not differentiate according to the sex of the member. They assume the member will use their savings to purchase a "single life annuity". Estimates are based on an interest rate of 3.0%.

Increasing Your Contributions Makes a Big Difference

Many DC pension plans let you choose how much to contribute. In some plans, your employer may match contributions you make. A great strategy to increase savings is to take full advantage of your employer matching contributions. Think of your employer matching contributions as an automatic return on your money.

Consider Martha, who decides to contribute an additional $100 per month to the plan. In Martha's plan, the employer matches these additional contributions at 100%. By contributing $100/month more to the plan, Martha doubles the income the plan provides at retirement.

Martha

Martha's total (employee and employer) contributions were previously $200/month.

Now Martha decides to contribute $100/month more and receives an equal employer matching contribution of $100/month more. This means Martha's total monthly contributions (employee and employer) are now $400.

Martha's estimated total DC pension plan savings will be $372,000. This doubles Martha's lifetime income at retirement to $1,880 per month.

How Did Martha Get There?

Average Annual Net Return: 3%

Savings Period: 40 Years

Age at Retirement: 65

Note: The amounts that Martha receives from their DC plan are in addition to any other income sources they may receive in retirement. These could include CPP / QPP, OAS, GIS, or income from other personal savings (e.g., individual RRSP, prior pension plan, personal investments, etc.).

Take Action!
Review the employer matching contributions available to you. These can help you reach your goals faster.

Consider that increasing your contributions today can have a significant impact tomorrow.

Fees Can Have a Big Impact

Be a savvy plan member! Review the fees you pay on the investment options you've selected. Fees are important because they reduce the amount you earn on your money. Fees are generally based on what your employer or union negotiates but different investment options may also have different fees. DC pension plans may offer lower fees than investing in a product such as an individual RRSP at a bank.

Lower fee investment options may not always be better. It is important to think about the value you receive for the fees you pay. For example, you might prefer higher fee investments if you believe they lead to higher or more predictable net returns. Your fees may also pay for other services, such as financial advice or other retirement planning tools. If these are available, you should take advantage of them!

Consider if Martha paid 1% in fees vs. the 2% investment fee Martha currently pays. In the example below, Martha would have more than $500 extra per month in retirement compared to Sarah, who continues to pay 2% fees.

Martha

Martha pays 1% fees.

At retirement, Martha's DC savings ($475,000) can provide an estimated lifetime income of **$2,400 per month**.

Sarah

Sarah starts contributing at the same time, contributes the same amount and has the same investment returns before fees as Martha, but pays 2% fees.

At retirement, Sarah's DC pension plan savings ($372,000) can provide an estimated lifetime income of **$1,880 per month.**

How Did They Get There?

Investment Return Before Fees: 5%

Monthly Employee contributions: $200

Monthly Employer contributions: $200

Savings Period: 40 years

Age at Retirement: 65

Note: The amounts that Martha and Sarah receive from their DC pension plan are in addition to any other income sources they may receive in retirement. These could include CPP / QPP, OAS, GIS, or income from other personal savings (e.g., individual RRSP, prior pension plan, personal investments, etc.).

A Big Increase in Martha's Retirement Income!

By enrolling early, increasing contributions by $100/month (with her employer matching that amount), and paying lower fees on the same investments, Martha's monthly income from DC pension plan savings in retirement is $2,400 as compared to $330 – the estimated income Martha would receive if Martha enrolled at age 45 and did not make these decisions. That is more than 7 times as much.

Resources can Help You choose Investments

Many (but not all) plans offer different options for investing your contributions. These options are generally made up of funds that hold many different underlying investments. You may have a choice between a hands-off option such as a balanced fund or a fund that adjusts your investments automatically as you age (a "target date" fund) or being more hands-on and picking what types of assets you want in your portfolio (e.g., equity, fixed income or money market funds).

It can sometimes feel overwhelming to choose the investments that are right for you. This is why many plans offer a "default investment" that may be suitable for most plan members. Your contributions are invested in the default investment if you do not choose an investment. But even if you do make a choice, the default option may be right for you.

To help you make investment decisions you should ask questions and use the tools your plan provides. These tools could include investment risk questionnaires to help you determine your risk tolerance. You should ask your plan administrator or employer what tools and resources are available to help make the right decision for you. Also consider seeking independent investment advice from a financial advisor.

Setting your goals and staying the course is important. Things in your life may change. You should revisit your choices on a regular basis (e.g., every year or when you experience a life event such as marriage, divorce, or death of a family member). From time to time, you may need to change your investments (such as less risky investments closer to retirement). But it is important not to overreact to short-term news and market trends. The research shows that retirement savers who avoid frequent investment changes do better in the long-term. Using available financial advisory services and tools will help you plan for your retirement and understand these good investing concepts.

How You Withdraw Retirement Income Matters

When you retire, you may have a few options to withdraw your money. You may do one or more of the following:

- Buy an insurance product that provides income until you die (an "annuity").
- Withdraw between a minimum and a maximum amount each year from a retirement product or, if permitted, from the plan.

Your monthly income from an annuity will be predictable for the rest of your life, while the amount you withdraw from other sources may vary.

In this Guide a "retirement product" refers to an account used to withdraw money in retirement. These might be called a "Life Income Fund" or "Retirement Income Fund." What is available to you may depend on your jurisdiction and circumstances.

In some cases, you may be able to immediately access a much larger portion of your retirement savings. This is called "unlocking." It may have significant tax or retirement planning implications. We encourage you to speak with a financial advisor before making important financial decisions about accessing your retirement savings.

How you withdraw your money and how you continue to invest the money you have not yet

withdrawn are important decisions. To make these decisions you should use the advice and tools the plan, your employer or your union provide or another trusted source of information.

For example, if you want to receive guaranteed monthly payments for the rest of your life you may be interested in purchasing an annuity. If you are comfortable managing your own money you may be interested in one of the other options. Consider these examples:

Lucas

Lucas wants to a receive a regular stream of income for life.

Lucas isn't concerned about leaving an inheritance and doesn't want to worry about managing investments during retirement.

Lucas decides to use most of the money in the DC account to purchase an **annuity.**

Joseph

Joseph has experience managing investments and wants some flexibility in withdrawing from the DC account.

Joseph decides to transfer most of the DC account to **a retirement product.** This requires Joseph to manage the account and withdraw between a minimum and maximum amount each year.

Martha

Martha isn't sure what to do with the DC account on retirement.

Martha would like to leave an inheritance but is also worried about managing investments without help.

Martha decides to **seek advice from a financial advisor** to get guidance and make a plan.

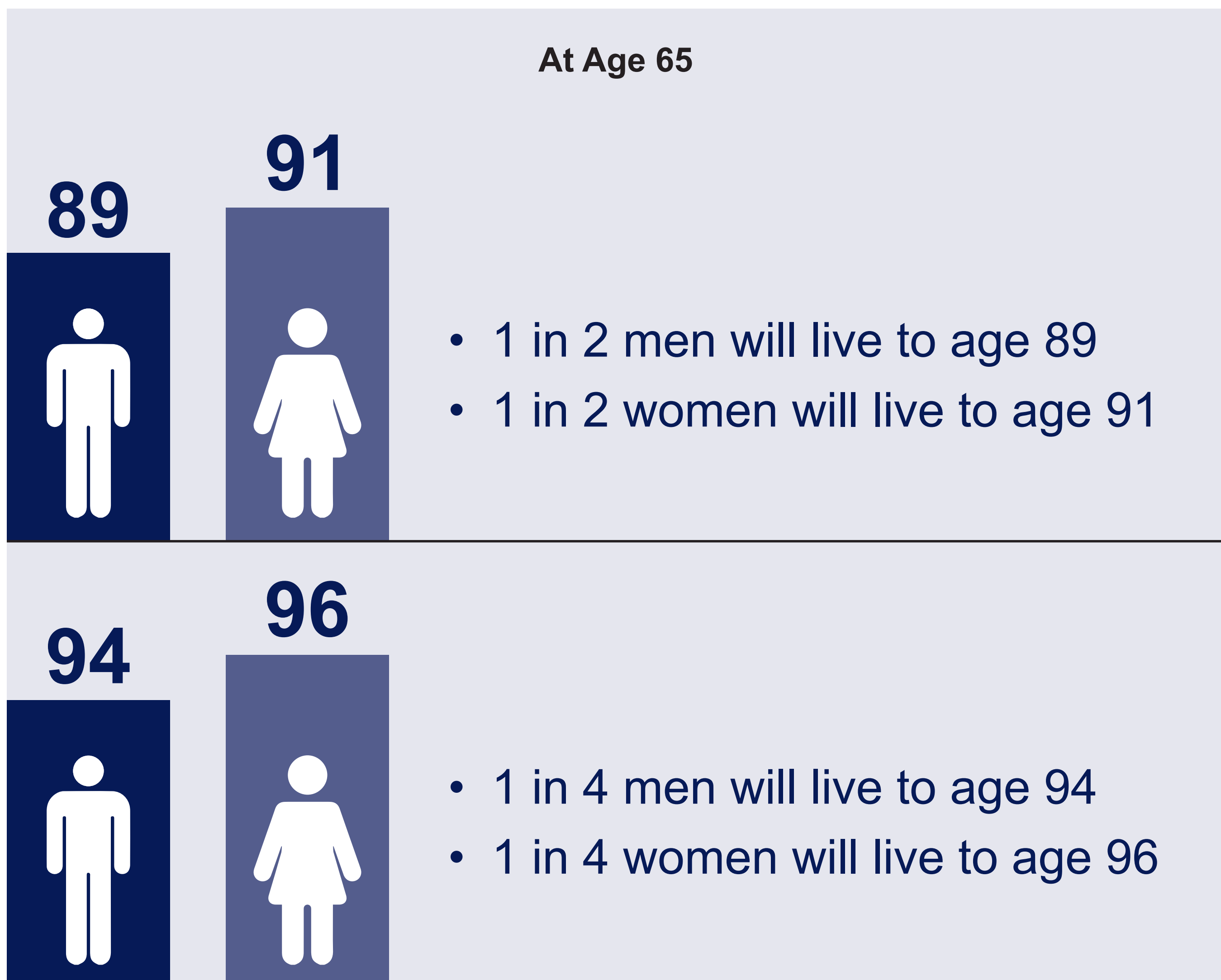
After receiving financial advice, Martha decides to split the assets about equally between an **annuity** and a **retirement product.** Martha will therefore receive a basic level of guaranteed annual income, but also have some flexibility.

Many people are like Martha. They aren't sure what is the best option for them. Finding the right financial advisor can help clarify what will work for them in retirement. Note that transferring your money from the plan may have implications in terms of the fees you pay or the protection of your money from creditors.

Ensure You Have Enough Money for the Rest of Your Life

Planning for retirement involves thinking about a lot of factors. One thing you may want to consider is how long your funds will need to support you in retirement. For example, you may be surprised to learn that on average, at age 65, 1 in 4 men will live to 94 and 1 in 4 women will live to age 96.

You can plan for this possibility by purchasing an annuity – which will provide guaranteed income until you die. But if you do not purchase an annuity, you should plan for the possibility that your assets will need to support you to these ages or longer.



To help plan against the risk of outliving their savings, some people may choose to defer starting their government income sources (such as CPP) to the latest date possible. One reason is that this increases the amount of monthly payments from these sources for the rest of your life. In other words, more of your income will be guaranteed in the event you live a very long time. CPP provides a guaranteed income stream for as long as you live – and it increases with inflation every year. If you are considering starting to receive your CPP before or after age 65, you should find out how that will affect your CPP payments.

More information about CPP can be found here. For 2021, the maximum CPP retirement income is $1,203.75/month. The average CPP retirement income in 2021 for new beneficiaries is $706.57.

Your Age and Retirement Savings Both Impact your Retirement Income

The amount of monthly income you can support with your DC savings depends on your age and how much you have saved. Similar to deferring government sources of income, in some cases you may want to delay drawing from your retirement savings in order to increase the amount of your retirement income.

The following examples show an estimate of how much retirement income Martha's DC savings of $475,000 could provide after transferring it to a retirement product if Martha retired at age 65. It also compares what happens to two of Martha's colleagues who are on the same savings path (same contributions, returns, and fees) but decide to retire at age 60 or age 70.

Thalia

Thalia stops saving and retires at age 60. Thalia's account balance reaches $367,000.

Starting at age 60, Thalia's savings could provide an estimated lifetime income of $1,650 per month.

Martha

Martha stops saving at age 65.

Starting at age 65, Martha's $475,000 account balance could provide an estimated lifetime income of $2,400 per month.

Niimi

Niimi keeps saving until age 70. Niimi's account balance reaches $607,000.

Starting at age 70, Niimi's savings could provide an estimated lifetime income of $3,580 per month.

Note: Thalia, Martha, and Niimi receive from their DC pension plan are in addition to any other income sources they may receive in retirement. These could include CPP / QPP, OAS, GIS, or income from other personal savings (e.g., individual RRSP, prior pension plan, personal investments, etc.).

As you can see in the above example, if you delay retirement and keep saving, the difference in monthly income your account can provide can be significant. This is because your account balance continues to grow, while your expected years spent in retirement decrease.

Generally, any retirement income will be taxable in the year you receive it. You should consider seeking independent financial advice. Choosing when you want to retire is an important decision in your retirement journey.