GROUP BENEFITS: Notes for Employees and Employers

By Gordon B. Clarke, CFP, CIM, OLS (Retired)

"Our biggest challenge is educating and encouraging plan members to get involved in selecting funds that will help them meet their retirement objectives. Historically, a vast majority of members have allowed their contributions to default to 'safe' minimum-growth funds, not realizing the risk of not having sufficient monies at the end of the day." The Canadian Defined Contribution Plan Trends Report - November, 2004

There was a time when employees, after spending their entire career with the same company, could look forward to a lifelong secure pension. As long as they worked to a normal retirement age, their pension benefit was pre-determined and at no time did they have to spend time or effort managing the funds.

Because the exact benefit is known in advance, this traditional type of pension is known as a defined benefit plan. The employee and employer contribute funds and a pension fund manager manages the money with the employee having no part in the investment process. However, these plans became expensive to operate and most employers have now opted for a different model known as a defined contribution plan (DC) where the investment risk is shifted to the employee. A company group RRSP is a common example of a DC plan.

Typically a group plan offers a selection of investments from which to choose. If they are unsophisticated or inexperienced investors, employees may not have any idea as to what these choices represent or their implications. Making inappropriate selections can have negative effects on post-retirement incomes and reduce the possibility of an early retirement option.

But there are potentially negative effects for the employer as well. In a DC plan, such as a group RRSP, the employee and possibly the employer make contributions. The investment choices and the management of the investment options are left to the employee, just as if it was their own RRSP. The eventual pension benefit will be determined by the performance of the investments and is not known in advance. A higher rate of return would lead to a larger accumulation of funds and a potentially higher retirement income.

So as you can see, in a group RRSP the responsibilities lay 100% with the employees. They must make the investment decisions and accept the consequences of these choices. With a possible unfavourable consequence being less than expected retirement savings resulting in a lower standard of living or maybe even a postponed retirement date.

When these situations occur, it would be easy to blame the employees, especially if they did not make the effort to assume responsibility for their own affairs. In fact a survey by Benefits Canada (www.benefitscanada.com) discovered that 44% of DC members parked 100% of their assets in the default investment option. In other words, they were *not* making investment decisions. But in the U.S.A., there have been court cases where employers have been sued for not offering the financial advice necessary to make these decisions. So there is potential for employer liability if they do not have a process to allow employees to access independent financial advice. The Benefits Canada study concluded, "In future, addressing plan sponsorship challenges around education and employee participation will be the key."

But what should employees be doing when they are making their investment selections? This of course depends on a multitude of issues. But of primary importance is that their employer's group plan should be treated with the same attention that their own RRSP's deserve. Many people take great care with their retirement savings, either by seeking professional advice or doing research before making investment decisions. But when it involves their group plans, they may have little or no idea where the money is going.

It would be impossible to address all the variables that could affect an investment choice. Every plan is different and every individual's circumstances are unique. So the best advice is to make sure that you fully understand your options and if you do not know the pros and cons of each option, ask your financial advisor or seek out professional advice. Keep in mind that with some plans, it is possible to transfer your funds into your own RRSP, which may make it easier for you and your advisor to monitor the progress.

Group Plans and Risk Management

Group benefits plans may offer life and disability insurance coverage. This is another area where a prudent employee should seek out advice. When I meet clients to do financial planning, I consider risk management to be the most important issue. There is no point in religiously saving for retirement, children's educations, etc. only to have it all wiped out for lack of proper insurance planning. I have lost count of the number of people I have met who do not know how much coverage they have through their group plan. While the standard response is "I am covered at work," they do not know the specifics. Some actually do not know if they have coverage at all. The group benefits booklet has been lying in a bottom drawer somewhere, unread for many years. I suppose these people will let their surviving spouses sort it all out while writing cheques to pay for the funeral and other last expenses.

Consider a group benefits plan that provides life insurance coverage for twice the employee's salary. A 40 year old making $50,000 per year will thus have his $1,000,000 of future earnings replaced by a $100,000 death benefit. A healthy 40 year old can currently get an additional $200,000 of life insurance for less than $25 per month so costs are really not a barrier to protecting a surviving family from drastic life style changes.

It is clear that employees need to treat their group plans with respect. They should spend the necessary time to examine the investment options, analyze the life and disability insurance coverage and seek advice if there is something that they do not understand. Ultimately they are responsible for their own actions or inaction. It is also clear that the landscape is changing for employers. Allowing employees to muddle up their retirement savings plan without having a process in place to access advice may soon be a thing of the past.

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