Communicating the Goal of the Retirement Plans

Taking a step back to define Retirement Income Adequacy

Western

Goals of the Retirement System

Society of Actuaries, Foundations of Actuarial Practice:

"Retirement systems are designed to provide income in retirement, so they protect against the **risk of lost income** after a worker stops full-time employment or begins phased retirement."

- What are the risks of lost income? Not necessarily the lost income itself, but the risk that consumption supported pre-retirement income is no longer supported.

- Are there some risks that are acceptable, or is the goal to try to continue with **same level of consumption**

Western Pension Plan Mission

*Our Mission is to provide members with the opportunity to accumulate **adequate funds** for retirement.*

How do we define retirement fund adequacy?

Replacement Ratios

- To date this is what we have suggested is a key metric to track in order to assess adequacy:

  $$\frac{\text{Total Projected Gross Pension Income before taxes}}{\text{Annual Base Salary just before retirement}}$$

- To what extent can my projected retirement income replace my pre-retirement salary?

- What is a good number?

Issues with Replacement Ratio

- Numerator
  - not easy to come up with Projected Pension Income
  - currently we are not including benefits from Supplemental Pension Arrangement,
  - Not including CPP, OAS
  - Need to consider inflation adjustments
  - Need to consider LIF withdrawal patterns

- Denominator
  - phased retirement, part time work, reduced workloads, as approach retirement
  - Stipends are not included
  - Should this be an average of actual income over the past 5 years?

- Expenditure pattern changes

- Inflation needs to be considered

Net Replacement Rate Matters

Average Western Salary	$71,197
Average Replacement Rate	34%
Retirement income	$24,207
OAS	$6,481
CPP	$11,840
OAS Claw back	-$0
Adjusted Income	$42,528
Adjusted Replacement Rate	**60%**
Net (after taxes) Western Salary	$53,112
Net (after taxes) Retirement Income	$36,981
Net replacement rate	**70%**

Opportunity with Replacement Ratios

- Allows comparison among members
- Allows comparison to defined benefit plans
- Can be adjusted to include income from other sources
- It measures impact of lost income – but is that really the right risk measurement?

Comparison to Defined Benefit Plan of Another Ontario University

"2% DB plan,
for 35 years service,
can get 70% replacement"

Defined Benefit Plan of Another Ontario University (fine print matters)

- Final Average Earnings (FAE) - your average annual base earnings during the 36 continuous months of highest earnings during your last 10 years of employment at the University.

- Year's Maximum Pensionable Earnings Average (YMPE Average) - under the Canada Pension Plan there is a maximum amount each year on which you make contributions to the Canada Pension Plan. This is referred to as the Year's Maximum Pensionable Earnings or YMPE. The YMPE Average is determined by averaging the YMPE in the year of retirement plus the YMPE's in the four preceding years. For example, in 2012 it is calculated as (44,900 + 46,300 + 47,200 + 48,300 + 50,100) / 5= $47,540.

(1.4% of FAE up to the YMPE Average
plus
2% of the amount of FAE in excess of the YMPE Average)
times
your number of years of Credited Service

This provides you an annual Single Life pension, guaranteed 10 years payable at your normal retirement date.

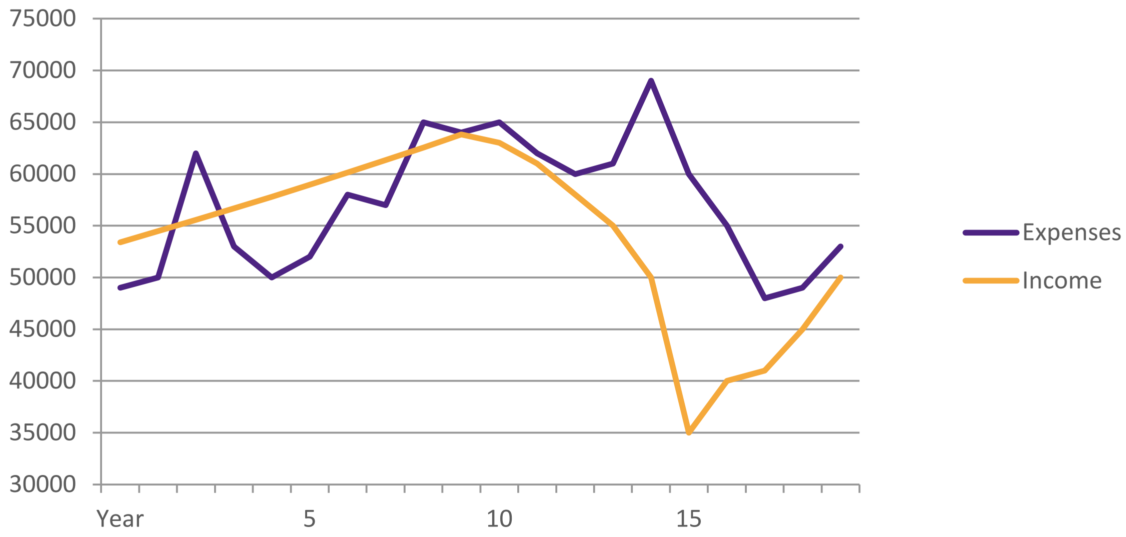
- 35 year staff member $71,197 retires in 2012; assume best 3 in last 10 years average $68,500
  $37,967 in gross pension, or 53% replacement of pre-retirement earnings

- 35 year faculty member earning $120,000 retires in 2012, assume best 3 in last 10 years $115,500
  $70,867 in gross pension, or 59% replacement of pre-retirement earnings

- Important to note that the staff member was contributing 6.5% of earnings and the faculty member 7.5% of earnings to receive this benefit

Other Metric Considerations

- Measure the risk of income not matching expenses; not the impact of lost income
- Expected expenditures versus expected income over retirement



What is a good answer?

How close is the Correlation between variable X (expenses) and variable Y (income) to +1?

- This works, but expenses which consistently exceed income will also be strongly correlated – so need to start with a reasonable match

Some Challenges with this approach

- Isn’t it OK if not highly correlated some year, if savings was part of the expenditure?
- Projected Expenditures highly unpredictable and variable based on life style and geographical location
- Appetite for debt varies among retirees

Another option: measure expected Consumption Estimate as a Proxy for Expenditures

Consumption = gross income – taxes – savings + debt

– Problem with this approach is that savings and debt are hard to predict and highly volatile over time

Option 3: Consumption Scenarios based on Lifestyle

- Average housing in London
- Life style supported by average salary at Western
- Consider supports provided in retirement: campus facilities, social networks, health and dental benefits
- Define an “adequate” expenditure pattern in London Ontario

Consider Variations

- Frugal
- Socialite
- Traveller
- Relocation to other urban or rural settings
- Chronic Health issues
- Financially dependent family members

Get Members to choose the variation aligned with their vision

- Which closely aligns with your vision in retirement planning stage

- Is reality a different variation? Alter the path as retirement years progress

Estimate Projected Cash Flows

- Include Western pension, spouse's pension, government programs, personal savings, equity in home

- Identify gap between Present Value of expense cash flows and Present Value of income cash flows

- Calculate the correlation over remaining retirement years

Introduce Workable Solutions: Pre-Retirement

If you can only afford Frugal expenditure pattern but want to travel, what else needs to happen?

- Increase contributions
- Delay retirement start date
- Manage volatility and growth of investments through investment selections

Introduce Workable Solutions: During Retirement

If you can only afford Frugal expenditure pattern but want to travel, what else needs to happen?

- Reduce Housing expenditures
- Find subsidized volunteer opportunities to travel abroad
- Take on short term debt with a plan to pay off travel costs

Which Variation is a Measure of Success for Western Plans?

- On average – adequate aligns with our mission
- Is there a different answer for faculty than for staff?
- Which variation is a good image to attract and retain our skilled workforce?
- Which variation supports the reputation of Western as a best employer?

Is this the right direction to go with our communication?

- Is if feasible to implement and maintain?
- Does it address the anxiety and unknowns for members?
- Does it align well with the Journey theme?
- How important are comparisons to peer organizations?
- Are there too many subjective assumptions to be made, reducing the integrity of the results?

Is this too much work for members?

- Member time and effort to articulate their vision and inventory their income sources is key to success – engagement has been a problem
- Need reliable data which is regularly updated about costs of living
- What can JPB and HR provide to members facilitate this new perspective in setting retirement goals?
  - Does it still seem appropriate to say “seek independent financial advise” or do we need to do more?