

HEALTH WEALTH CAREER

REPORT TO THE CANADIAN MEDICAL ASSOCIATION ON POTENTIAL RETIREMENT SAVINGS OPTIONS FOR CANADIAN PHYSICIANS

EXECUTIVE SUMMARY

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BACKGROUND AND CONTEXT

Recently, a number of physicians have signed a petition, asking CMA to consider implementing a national pension plan for Canadian physicians. Mercer has been asked by CMA to identify potential options to improve physicians' retirement income security.

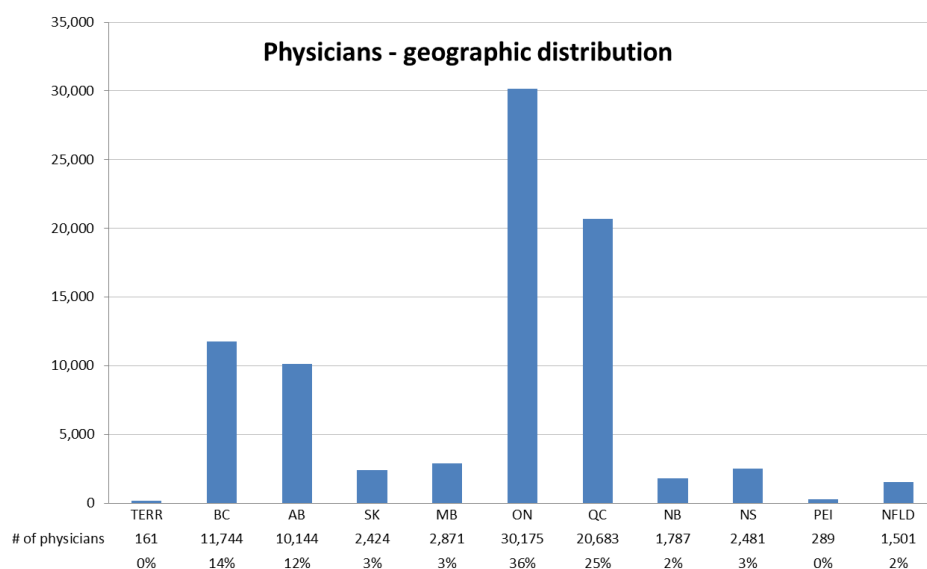
Our report focuses on the majority of physicians, who are self-employed (30%) or incorporated (65%). Canadian pension plans are exclusively offered through employers. This premise pervades the entire system at a very deep level, making it impossible for a third party like CMA to contribute directly to a pension plan for self-employed or incorporated physicians.

Retirement income security can be improved through one or both of the following:

- Greater certainty of retirement income; and
- Greater levels of retirement income

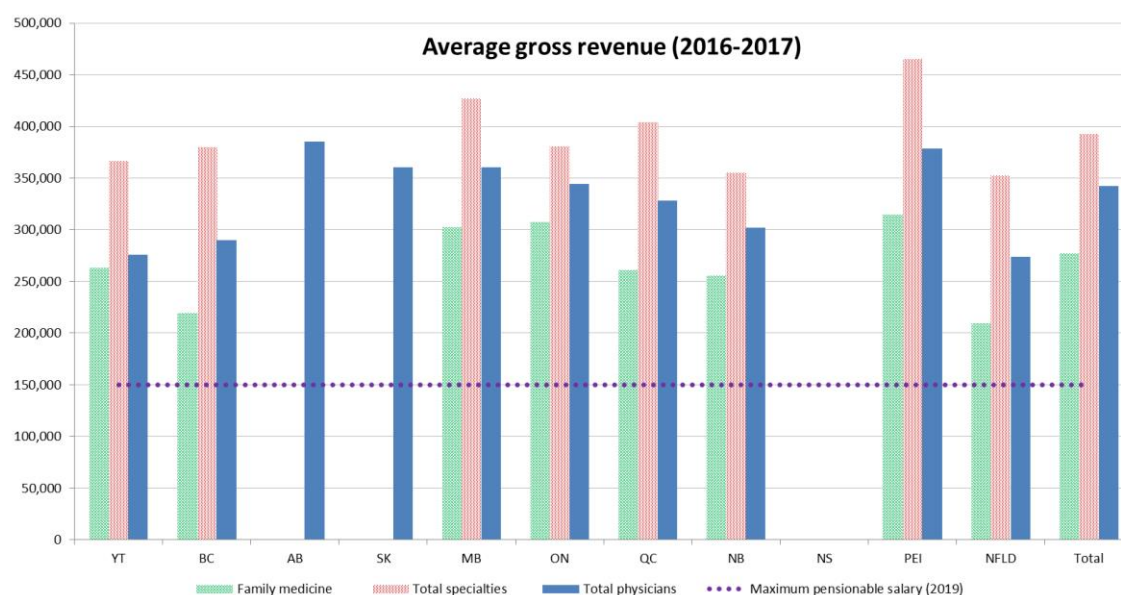
CURRENT STATUS OF CANADIAN PHYSICIANS

Canada's 84,000 physicians are distributed across the country, with the highest concentration (over 60%) in Ontario and Quebec, as shown below:



Source: Canadian Medical Association

The following graph shows the average gross revenue (before overhead) of physicians across the country. For reference, the graph also indicates the approximate salary on which maximum pension contributions and benefits are based under the *Income Tax Act*.



Source: Canadian Medical Association (information not available for all regions)

BACKGROUND ON CANADIAN RETIREMENT SYSTEM

The Canadian retirement income system is often described as having three pillars:

Pillar 1: Government pension plans to reduce poverty

The government offers two plans in this pillar: Old Age Security (OAS) and Guaranteed Income Supplement (GIS). Canadian physicians are not likely to receive benefits from these plans, since they are income-tested.

Pillar 2: Canada/Québec Pension Plan (C/QPP)

These plans offer a basic, employment-based lifetime benefit. Self-employed workers pay both the employee and employer shares of the cost.

Pillar 3: Private employment-based pension plans and personal savings

The purpose of this pillar is to provide Canadians with an opportunity to increase their retirement income beyond the basic level, through one or more of the following vehicles: Registered Pension Plans (RPPs, both defined benefit (DB) and defined contribution (DC)), Registered Retirement Savings Plans (RRSPs), Tax-Free Savings Accounts (TFSA), and non-registered savings.

CANADIAN RETIREMENT SAVINGS PLANS (PILLAR 3)

Canadian retirement savings plans have traditionally been grouped into one of the following two categories:

- Defined Benefit (DB) pension plans
- Capital Accumulation Plans (CAPs)

Defined Benefit pension plans

A traditional DB plan is an RPP that delivers a lifetime monthly benefit to the member upon retirement, according to a set formula.

In DB plans, the benefits for each member can be determined in advance, but the contributions required to fund that benefit cannot be predicted with any degree of certainty. The risks underlying these plans (interest rate movements, equity market risk, inflation, and longevity), which are pooled over the group of members and spread over time, are borne by the entity (or entities) responsible for funding the benefits, most typically the employer(s) of the members.

Capital Accumulation Plans

Capital Accumulation Plans (CAPs) include Defined Contribution (DC) RPPs, Registered Retirement Savings Plans (RRSPs), Tax-Free Savings Accounts (TFSA), and non-registered savings. While these different sub-types differ in their details, they are largely similar, in that members and/or employers contribute amounts to individual accounts, and each individual's balance is invested, with the proceeds payable from retirement. In most cases, the investment decisions are made by the individual members, who are provided with a range of investment options.

In these plans, the contributions can be determined in advance, but the future benefits that will be paid out to the member cannot be predicted. The risks underlying these plans are the same as those affecting DB plans, but are borne solely by the individual members.

Other options

In addition to the two basic types described above, there are a number of other options that fall between those two extremes, including:

- DB-DC hybrids: pension plan with separate DB and DC components
- Adjustable benefit plans: benefits and contributions are defined in advance, but neither are guaranteed, and can be adjusted as experience evolves
- Individual Pension Plans (IPPs): DB plan for a single individual

OPTIONS FOR CANADIAN PHYSICIANS

In our report, we have assessed the available options for enhancing physicians' retirement savings, considering the two primary methods of achieving greater retirement income security: greater certainty of benefits, and greater level of benefits. We have identified three potential options for further research and consideration, as described below.

CAP Decumulation Support

Currently, the majority of Canadian physicians are saving for retirement using CAPs. We believe there may be potential to improve the efficiency of these plans to deliver retirement benefits (i.e. decumulation of funds after retirement), through one or more of the following market innovations:

- Pooling of longevity risk during CAP decumulation
- Auto-adjusting investment funds for decumulation phase
- Favourable pricing for annuity purchase

Group Individual Pension Plan (IPP)

IPPs may be a good option for many physicians, as they can provide greater tax-assisted savings than is possible through CAPs such as RRSPs and DC RPPs. However, we understand that very few currently have an IPP, likely as a result of relatively high administrative costs (both initial and ongoing).

We think it may be worthwhile to explore the feasibility of a “group” IPP. Under this approach, a central agency could offer IPP services to physicians on a one-stop-shopping basis. The design options could be very limited, and all such participating IPPs would use the same service provider(s) for the required services, to reduce fees through standardization. The participating IPPs would not pool their risks (e.g., investment, longevity), but could benefit from favourable group annuity pricing as mentioned above for CAPs.

Adjustable benefit plans

In theory, a single, broad-based pension plan for incorporated physicians could be set up as an adjustable benefit plan, with the physicians acting as both members and employers. This type of design could bring together some of the advantages of a DB plan (risk pooling and greater benefit predictability, albeit with lower guarantees) and those of CAPs (cost certainty).

We have identified below a number of challenges to the successful implementation of such a plan.

Regulatory challenges

Adjustable benefit plans can take many forms (e.g., MEPP, JSPP, TBP), and various rules apply in different provincial jurisdictions. It will be very challenging to design and implement such a plan for physicians that will work within the rules as currently set out.

Incorporated physicians would be the sole contributors to the plan, through their personal corporations). CMA would not be permitted to contribute directly to the plan, since there is no employer/employee relationship with CMA. Self-employed (non-incorporated) physicians would not be eligible to participate, for the same reason.

Administration

Even if this plan only covered the majority of incorporated physicians in the two largest provinces, such a plan would have approximately 35,000 participating employers. The plan would need to work with each of these employers to verify eligibility and register participants, exchange data, collect contributions, communicate with participants, and administer benefit payments.

Our report compares this to two large, well-known Ontario pension plans serving multiple employers, and notes that a Canadian physicians' pension plan would involve over 50 to 200 times as many employers as in these examples (with "employers" being, in most cases, the physicians themselves), while serving fewer members. The administrative complexity and cost of this structure would likely prove to be significant, both for the plan and the individual employers.

Governance

An adjustable benefit plan should be governed by a group representing interests of, and accountable to, the employers/membership. Who would serve on such a Board, and how would those members be selected? What sort of actions would be taken in periods of adverse experience (e.g., poor investment returns, increasing longevity), and who would decide? How will this Board communicate effectively with all participants?

Equity

Issues of equity between subgroups of members in a DB plan (e.g., young vs. old, male vs. female, past contributors vs. current contributors vs. future contributors) could be heightened in a plan where each employer only covers a single member.

For related reasons, voluntary participation could cause an anti-selection issue, in which only older physicians would tend to join the plan, thereby driving up the cost and making the plan less attractive to younger members.

Summary

The chart below summarizes the options presented above.

	CAP DECUMULATION SUPPORT	GROUP IPP	ADJUSTABLE BENEFIT PLAN
Improvement relative to status quo	<ul style="list-style-type: none"> Increased benefit certainty through longevity pooling and/or more favourable pricing for annuity purchase Risk reduction through more appropriate targeted fund line-up Greater level of income through lower fees 	<ul style="list-style-type: none"> Lower costs and product simplification may increase interest among physicians Greater level of retirement income than can be achieved through CAPs 	<ul style="list-style-type: none"> Greater benefit certainty (DB-like design, with high degree of risk pooling) Greater level of retirement income than can be achieved through CAPs
Challenges	<ul style="list-style-type: none"> Potential legal impediments to longevity pooling More research needed to determine detailed design options Willingness of providers to develop appropriate products at competitive cost 	<ul style="list-style-type: none"> Further research needed to identify reasons for current low utilization rate, and develop specific solutions Willingness of providers to develop appropriate products at competitive cost 	<ul style="list-style-type: none"> Legislative / regulatory Administration / communication complexity Governance Equity Implementation

PRELIMINARY CONCLUSIONS

Currently, most Canadian physicians' only options for retirement savings are Capital Accumulation Plans. The Canadian retirement income system offers many options, but there are particular challenges in implementing these options for physicians:

- The tax advantages offered in the system are limited, and Canadian physicians would likely need to save additional money on a non-registered basis in order to provide themselves with an acceptable level of income replacement during retirement.
- Much of the Canadian retirement income system is built around employer/employee relationships and employment income, which is not naturally well suited to the situation of most physicians. This basic premise, which underlies current pension taxation law, is unlikely to change.

It is important to note that, due to the lack of an employer/employee relationship, CMA would not be permitted to contribute directly to funding a pension plan for physicians. Therefore, in every option presented herein, all funding would come from the physicians themselves.

In this report, we have identified a few potential solutions for Canadian physicians, as follows:

- For physicians who are incorporated, an employer/employee relationship does exist, which could theoretically be used to establish a broad-based multiple-employer adjustable benefit plan.
- Greater support during CAP decumulation, including longevity pooling; and
- Streamlined group Individual Pension Plans.

MERCER (CANADA) LIMITED

55 Metcalfe Street, Suite 550

Ottawa, Ontario K1P 6L5

www.mercer.ca

Mercer (Canada) Limited

