Key Employee Retention

Solving the Retirement Concern

Money Purchase Pension Plans like RRSPs have contribution caps. The result is that employees must set aside additional funds for retirement. Using after tax employment income and bonuses is not the most efficient way of building another "retirement living pot".

Employee Concerns

There is much talk of **"pension problems"** and **"shortfalls"** but little action. Employees want solutions. Companies that grasp and take the initiative will be rewarded. Those that do not, risk the loss of key employees to other employers**. For Empathetic Employers** that understand the pension dilemma and the need for guaranteed **"Living Money",** Guaranteed Target Benefit Supplemental Pensions funded and secured by Group Retirement Compensation Arrangements are the solution.

According to a recent article in Canadian Business **"77% of Canadians would switch jobs for better retirement benefits"** (study by ADP Canada)

In today's investment climate, most Employees have no real idea what their retirement income will be. It is a guesstimate at best for most.

Pensions came to the labour market to generate loyalty and provide incentive to stay with a company to retirement. But, today's pension landscape provides no such incentive.

Employer Solution

A **Corporate Supplemental Pension Plan (**CSPP) is the best way to provide such retirement income. Companies that implement will be rewarded

Grateful Employees will be motivated to stay with their Employer until normal retirement to collect.

Shareholders/Owners are rewarded in the long-term by the retention of their most valuable asset, an experienced and loyal work force.

Retirement Compensation Arrangements

Defined under Sec 248 (1) of the Income Tax Act, contributions are **100% tax deductible** to the Corporation and, **employees pay no tax** until benefits taken in retirement. For pension planning, CSPPs are a more **desirable benefit** than a cash bonus, restricted stock and option arrangements.

Gross Benefits

Under "Generally Accepted Guidelines", the normal pension formula in Canada is 2% x years of service (max 35 years) x final average earnings. With contribution caps and a volatile investment environment for MPPPs/RRSPs, it is unlikely that target levels will be met.

Retirement Anxiety

Key Employees are assets, their productivity driven by loyalty, satisfaction and compensation. Most key employees are 45 plus with thoughts of a comfortable retirement on their minds. Many suffer from "retirement anxiety" resulting from the concern over market performance and the effect on "money purchase" benefits. They cannot dollar average in their RRSPs with make-up contributions and they are concerned that lost asset values may never recover.

As worrisome, is the ability of an Employee's other investment assets to make up the shortfall in pension benefits. By the time most Employees hit retirement, have paid off their mortgage, educated their children, and perhaps invested in a recreational home, they have little in other investments. Potential inheritances can be delayed/reduced if parents live beyond normal life expectancies. In fact, some retirees might have to provide financial assistance to parents.

Pension Income for most retirees is the most important and critical component of their retirement. The loss of even $2k monthly can turn retirement into one of despair.

Supplemental Pensions used strategically can provide a corporation major benefits.

Living Target Benefits

What every Employee wants and needs is a minimum guarantee to provide **"Living Money"** in retirement. If investments in the RRSP or MPPP do not perform, all is not lost.

"Play Money" comes from other investments, inheritances etc.

A site superintendent in a construction company can be at a lower pay scale than their CFO but, be more valuable to the company from the expertise lost to a competitor offering Supplemental Pension Benefits.

Outside of the box thinking re pensions can protect a company from its most valuable assets leaving. Providing key employees with their "Living Money" is the most valuable benefit a company can offer.

Supplemental Benefit Options

To design a retirement compensation package that satisfies both the company and key employees a number of factors have to be considered strategically.

- Affordability
- Sustainability·
- Fit to long term planning·
- Value to Shareholders·
- Effect on saleability

An engineering firm started and owned by one group of engineers, with profits that are generated equally with employee engineers, has fairness and equity issues between engineers but, all engineers have the same dependency of employees in the drafting department.

Individual "*Maximum Benefit*" Plans

Fully Integrated RRSPWrap or IPPWrap/PPPWrap at 2% x years of service x final average earnings, indexed or non-indexed.

Group *"Target Benefit"* Plans (non-integrated)

Can be designed to allow movement from one tier to another relative to position or years of service.

Tier One: 1% x years of service (maximum 35 years) x final 5 year average income (ie: $300k final average and 20 years service provides an additional $60k pension).

Tier Two: a flat monthly benefit ($1,500 to $5,000 monthly) and can be adjusted for the time value of money.

Tier Three: a monthly amount x years of service $50; $75; $100 or $150 max) indexed from retirement ($75 per year x 30 years = monthly benefit of $2,250 or $27,000 annually)

Affordability

No Business Owner wants to provide a benefit that is not affordable. Contributions can be tied to company profitability meaning, if predetermined revenue / sales targets are not met, there are no contributions but, with catch up provisions. Plans can work within an existing compensation package (salary, bonus, retirement plan contributions, paid holiday, etc.) or be an "add on", based on the company's objective of including key employees in the success of the company.

Market risk of providing the Defined Benefit promise is mitigated by the conservative professional management of assets within the RCA including a mortality component on employees covered.

Supplemental Retirement benefits can be cost effective and simple to administer.

Sample “Target Benefit” Costs

Key Employees are an asset of immeasurable value. Retaining them through the strategic use of long term asset allocation can offer much more than the value of the underlying asset.

Is it likely less expensive to incur some deductible expenses in providing supplemental pension benefits in return for employee loyalty than to lose a key employee, with the cost of replacement and effect on productivity?

As well, it is likely better for a company to have long serving employees mentor younger talent either recruited or promoted to bring in new ideas and energy than having employees that should be retiring, trying to work longer because they cannot afford to retire?

Overall compensation can include base salary, cash bonuses and other benefits. One such other benefit may be a Supplemental Pension. This could result in the change of other components better aligned to the company future but also, welcomed by employees.

Providing a Guaranteed Target Benefit to employees for years of service to normal retirement can be a valuable component given the uncertainty of their money purchase plan and, in the long run, probably does not cost the employer much more than the current benefit package.

The chart below shows the annual cost of funding monthly Guaranteed Target Benefits of $50; $75; $100 and $150 per year of service. At the $100 per year of service, an employee would have an additional $3,500 monthly (indexed or non-indexed). The monthly Target Benefit can be varied up to $5,250 monthly (for 35 years of service at $150 per year).

Since all employees are in the same Group RCA, the employer’s risk of the guarantee is mitigated, in that, all employees and spouses will not live to mortality projected and, that the cost of providing the survivor benefit can be locked in by passing risk to an insurance company. Remainder funds go towards future retirees.

Assumptions

Mortality	Male	86
	Female	90
Age at Retirement		65
Years of Service		35
Earnings		4.50%
Benefit Indexing		2%
Spouse Ages (F) - minus 3 years		
Survivor Benefit		66.66%

Funding costs increase the older the employees but, older employees usually also have higher compensation packages. The Target Benefit can also be adjusted for the time value of money. What this does is ensure that each employee is receiving the same purchasing power of the Target Benefit. The additional cost of funding is on younger employees who have a lower cost of funding for the base benefit.

Target Benefit Plans - Annual Funding Costs

Monthly Benefit per year of Service		**$50**	**$75**	**$100**
Annual Benefit x 35 years		**21,000**	**31,500**	**42,000**
Age at Establishment				
35	Non-Indexed	10,090	15,135	20,180
	Indexed	12,845	19,268	25,690
40	Non-Indexed	12,873	19,309	25,746
	Indexed	16,388	24,582	32,776
45	Non-Indexed	17,090	25,365	34,181
	Indexed	21,757	32,636	43,514
50	Non-Indexed	24,177	36,266	48,355
	Indexed	30,779	46,169	61,559
55	Non-Indexed	38,439	57,659	76,879
	Indexed	48,936	73,404	97,872

There is considerable flexibility in designing a Target Benefit plan to accommodate various divisions or departments within a company including or excluding indexing and, offering flat benefits (providing they would not be considered unreasonable under CRA guidelines).

Incentive to Employees

Oftentimes, cash bonus arrangements do not provide the long term incentive that the employer wishes. Once tax has been paid by the employee, the net funds get mixed in with other assets and, most are not disciplined enough to focus on their retirement. This does not mean that they do not want to. Even for those that do, the tax is paid up front. The value of a Target Benefit Plan is that they can see what is being set aside and, what the benefit is to them if they remain with the company to retirement. The employer also knows that key employees are more likely to stay until retirement to collect the benefit. A win, win.

Median Value to Employee of Non-Indexed Benefit				
Annual Benefit		**21,000**	**31,500**	**42,000**
Age Start	35	302,700	454,050	605,400
	40	321,825	482,725	643,650
	45	341,800	507,300	683,620
	50	362,655	543,990	725,325
	55	384,390	576,590	768,790
Funding Cost Spread		81,690	122,540	163,390

Median Value to Employee of Indexed Benefit				
Annual Benefit		**21,000**	**31,500**	**42,000**
Age Start	35	385,350	578,040	770,700
	40	409,700	614,550	819,400
	45	435,140	652,720	870,280
	50	461,685	692,535	923,385
	55	489,360	734,040	978,720
Funding Cost Spread		104,010	156,000	208,020

Vesting

As desired by employer. Employees leaving earlier forfeit benefits and, their contributions lower funding costs for remainder. Employees close to vesting are unlikely to move to other employer providing security to employer that valuable employees will remain to retirement.

Group RCA

The best solution utilizes a Group RCA for all employees, with a strategic mix of assets including individual life contracts on insurable members for survivor benefits and yield enhancement. "Exempt" insurance contracts held by RCAs compound tax-sheltered assets until death thus increasing efficiency of RCA Investment Account.

Conclusion

Key employees can be a company's most valuable asset and it is important that owners maximize the value of their investment in these employees. A company would not invest in other assets without determining the impact on short and long term values. This should be the same for key employees.

What is lost if a key-employee with years of expensive training and experience walks out the door? What value is lost to shareholders?

Key Employees are an asset of immeasurable value. Retaining them through the strategic use of long term asset allocation can offer much more than the value of the underlying asset.

Building a separate asset pool is beyond the ability of many employees. Unless they are inheritors, most today suffer from retirement anxiety.

Designing a compensation package that satisfies both the company and key employees can be of considerable value to both sides.

Interested

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