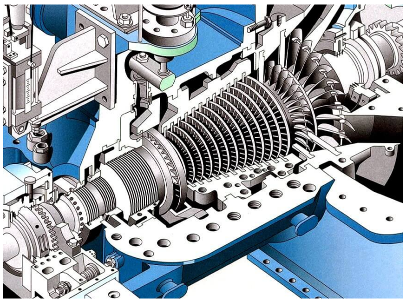
A Policy Dynamo Touts 'Dynamic Pensions'

By Kerry Pechter *Thu, Feb 24, 2022*

Bonnie-Jeanne MacDonald, an actuary and retirement policy expert at Canada's National Institute on Aging, claims that a non-guaranteed lifetime income tool could generate more income than any annuities. Tontines, anyone?



We first met Bonnie-Jeanne MacDonald four years ago in Manhattan. The Canadian actuary was in New York to tell the gathered members of the Defined Contribution Institutional Investors Association about her retirement research and, in a sidebar, we talked about her "LIFE" plans.

LIFE, in this case, stood for Lifetime Income for the Elderly, a type of personal pension that MacDonald and others had developed for the Canadian market. Retirees would invest in an irrevocable LIFE contract at age 65. At age 85, they would draw a variable stream of income that was managed, though not guaranteed, to last until they died.

If LIFE sounds familiar, it should. It has elements of **tontines**, of TIAA's **CREF** variable income annuity, and of deferred income annuities (DIAs). Those are niche products; the positive reception that LIFE got from Canada's regulators and legislators gave MacDonald a feeling that her version of an old idea could find a bigger audience.

Bonnie-Jeanne MacDonald

"Everybody bought into the idea that Canadian retirees needed something more than annuities and drawdowns (i.e., system withdrawals) to produce retirement income," she told *RIJ*. "They needed a third option."

Prodded by MacDonald and others, the Canadian government eventually revised its tax laws, opening the door to something larger than LIFE. Now Canada's defined contribution (DC) plan sponsors and Pooled Registered Pension Plans—savings plans for those without DC plan coverage—can offer income starting at age 65 and lasting for life.

As the lead actuary on the project, MacDonald picked out a name for the latest iteration of the program: **Dynamic Pensions**. "We put a new **white paper** out, it's been fully circulated, and we just did presentations on Dynamic Pensions across Canada," she said in an interview. "This time, we hit the bull's eye."

Two nations, similar challenges

Canada's retirement industry, like that of the US, is playing catch-up with demographic imperatives. Canadian boomers are retiring from DC plans with big chunks of tax-deferred savings but with no direct mechanism for turning the nest eggs into what most people say they want: a pension-like income.

Like Americans, Canada's DC participants tend to roll their money into tax-deferred brokerage accounts at retirement. But Canadian plan sponsors and asset managers, like their American counterparts, would like to retain more of those fee-generating assets and maintain economies of scale.

In the US, insurers are trying to integrate annuities into DC plans, and Congress, with its SECURE Act, has helped. Just last week, it was announced that Morningstar would link its 401(k) managed accounts to Hueler's online annuity platform. But few Americans buy income annuities.

MacDonald's Dynamic Pensions would be cheaper than annuities, which means they'd produce bigger monthly checks for retirees. They'd be cheaper because, as in the LIFE program, participants would bear their own investment and longevity risks instead of hiring life insurers to do it for them.

How Dynamic Pensions work

Like Americans, most Canadians who aren't covered by defined benefit pensions save for retirement in a variety of tax-deferred savings vehicles. These include employer-sponsored defined contribution plans and, for individuals, Registered Retirement Savings Plans (RRSPs), which resemble IRAs.

At retirement, Canadians who want lifetime income can buy a life annuity from an insurance company or move their tax-deferred savings into a Registered Retirement Income Fund (RRIF), or a Life Income Fund (LIF), from which they can draw down a taxable income. (Distribution rules can vary from one province to another.)
Under MacDonald's plan, at retirement Canadians could roll all or part of their tax-deferred savings into a large, professionally managed fund composed of stocks, bonds, and sophisticated alternatives. Depending on their age and the amount of their contribution, they'd be credited with a certain number of income units.

Participants would receive a guaranteed number of *units* of income each year. But the dollar-value of the units would not be guaranteed. Instead, the units would fluctuate in value from year to year, depending on the performance of the underlying fund. As years go by and participants die, their assets would stay in the fund.

Like an annuity, a Dynamic Pension would have to be illiquid and irrevocable. That's the only way to maximize income. An optional death benefit or guaranteed period might be added, but payouts would be smaller. But illiquidity might be more palatable in a Dynamic Pension than in an annuity because—without the expense of a life insurer guarantee— the income would be significantly higher.

Sounds familiar

The DP idea isn't new. In fact, it will turn 70 years old this year. In 1952, the leaders of TIAA, then the not-for-profit Teachers Insurance and Annuity Association, invented **CREF**, the College Retirement Equities Fund. CREF was the first deferred variable annuity and, at retirement, it can be converted to a variable *income* annuity.

CREF is still a pillar of TIAA's offering, available at colleges and universities in the US and abroad. It has even been cloned. The University of British Columbia has replicated a CREF-like plan since it broke with TIAA some 40 years ago. UBC calls its version of CREF a **Variable Payment Life Annuity**.

The CREF/DP idea was adopted in 2021 by QSuper, a former non-profit public employee's retirement savings plan that was opened in 2017 to all Australians. At retirement, participants can put all or part of their savings into the **QSuper Lifetime Pension**, which works just like CREF or a Dynamic Pension.

Dynamic Pensions are a lot like **tontines**, which were investment pools that paid out income to their members for as long as members were alive—or as long as a designated annuitant was alive. A Dynamic Pension would produce a more level income than a tontine, because early payments would anticipate the impact of future mortality. Moshe Milevsky, a **tontine expert** and professor at York University in Toronto, has advised MacDonald on Dynamic Pensions.

Not quite there yet

Even though some of the legal barriers to Dynamic Pensions have been cleared away, hurdles remain. DC plans can offer Dynamic Pensions, but DC plans cover only a small minority of Canadians. Also, there aren't many DC plans in Canada that, by themselves, have large enough participant pools to make Dynamic Pensions work.

Insurance companies could use their recordkeeping and asset management skills to run Dynamic Pensions, but at the risk of undercutting their retail annuity businesses. MacDonald herself would like to see stand-alone not-for-profit entities offer Dynamic Pensions to any Canadian who wants one.

"Canadians won't buy into something like this without trust," MacDonald told *RIJ*. She thinks it's just a matter of time before her vision for Canadian retirees comes true. "A lot of thought leaders in government and industry believe Dynamic Pensions are the right thing to do. There's a lot of good will toward making it work."