

CIRANO note based on a report by Bryan Campbell, Laurence Allaire, Vinh Nguyen, Paul Gauthier, Richard Guay, Michel Magnan, February 2013

The concept of **cashing out** refers to actions taken by individuals at the time of retirement, when they convert their savings into retirement income. This may involve purchasing an annuity, cashing out directly, or some hybrid solution. In a context of voluntary savings (such as Voluntary Retirement Savings Plans, or VRSPs) this task falls to the individual saver, but the government of Quebec (which introduced VRSPs) might be able to play a roll in providing information to the saver and/or suggesting the best default option.

The authors of this report consider that the options currently available on the market may not be optimal in a context of VRSPs. Moreover, in other countries we see approaches that could serve as models to help the government guide savers into a default option, in partnership with financial institutions, and that would not require public financial involvement.

CIRANO's Pensions Team proposes a **synthetic life annuity** option in the form of **staggered-maturity bonds**. In this option, workers' savings are used to progressively purchase **bonds** that mature in successive years, so as to provide a guaranteed income for each year of retirement until some predetermined age. More precisely, these bonds would progressively mature at the ages of 65 years, 66 years, 67 years, ..., 90 years, and 91 years, thus providing "quasi-lifetime" annuities. Hedging **longevity risk** beyond these ages could be too costly and unnecessary, because the pace of life slows and individuals will continue to collect pensions from the federal (OAS) and provincial (QPP) schemes. In addition, since these bonds are liquid and reversible products, they could be sold if the person becomes invalid, or transferred at the time of death. Thus, this option respects the **voluntary** objective of VRSPs. Also, when these funds are aggregated across individuals, this option could create considerable purchasing power and reduce the cost of bonds while providing bond issuers, such as the government of Quebec, with a steady clientele. Finally, it would highlight the linkage between the objectives of retirement income and investment decisions made during the accumulation phase, allowing for a more dynamic approach geared to the life cycle.

To arrive at this proposal, the report provides an overview of the various options currently available on the Quebec market and presents the strengths, weaknesses, and risks of each one. A hybrid option, **Guaranteed Lifetime Withdrawal Benefits (GLWB)**, is analysed in some detail, since the market for these products has undergone radical changes; in fact, they do not seem robust enough to survive current economic conditions. What is more, financial problems with GLWB products appear to be as detrimental to the beneficiary as to the companies that sell them. A **financial** and a **quantitative analysis** of GLWBs is presented in the report.

This is followed by a brief international overview. Three pension plans were selected for their relevance and the originality of their approach. In the **United States**, the *TIAA-CREF* fund has a **deferred compensation plan** that allows for better management of market risk (especially fluctuations in interest rates and the associated pension costs). Also in the United States, the fund manager *BlackRock* offers a **life-cycle** approach that is more focused on goals related to cashing out than on accumulation. In both cases, the link between the accumulation (or saving) phase and the cashing out phase is in the forefront. Finally, in the **United Kingdom**, the *NEST* fund was set up to provide a simple solution for employers offering a new voluntary savings plan—very similar to VRSPs. The approach taken by this fund in the matter of cashing out, at the time this report was written, is to primarily play an **advisory role** for savers to facilitate their decision when purchasing an annuity.

The report concludes with CIRANO's proposal and paths for further research, and it can be consulted on CIRANO's Website at the following address (French only):

<http://www.cirano.qc.ca/pdf/publication/2013RP-02.pdf>