DC DECUMULATION
Are your employees ready to manage their income in retirement?

Early on June 11, 2015 more than 70 industry participants gathered at the InterContinental Toronto Centre to hear the thoughts on DC Decumulation from an expert panel looking into the retirement planning and legal requirements of sponsors when it comes to decumulation. This white paper summarizes the discussion.

Quotes

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Over the next 10 years, retiring members of defined contribution pension plans will be facing decisions on how their almost $2 trillion in DC assets will pay for their retirement. Their ability to shift from accumulation to decumulation is a growing concern for both employees and employers. Employees are questioning whether they will have enough retirement income to last for 20 or more years and are looking to plan sponsors to provide the guidance they need. Employers are concerned they may be liable if they do not provide that guidance successfully.

“Pension plan sponsors need to completely rethink their defined contribution philosophy,” says Dr. John T. Por, founder of the Decumulation Institute. Speaking at the Benefits and Pensions Monitor Meeting & Events session, ‘DC Plan Decumulation,’ he said DC plans have a well-designed accumulation phase, but plan members are looking at a decumulation dilemma with high retail fees and a lack of professional management. Members need opportunities which offer longevity protection, growth (because their desired lifestyle is richer than they really are), and safety because they have no further assets.

Few Options

Por asks, who will help them think this through? Who will have the products? And, how can they put this all together? He said plan sponsors have a few options. They can stick to the status quo and hope for the best, they can communicate core decumulation concepts for member decision-making, or they can work with recordkeepers for a life cycle solution that covers accumulation as well as decumulation. The choice

Retiring Plan Members Need Advice On Converting Assets

By: Nienke Hinton
sponsors make is best driven by a conscious policy, he says.

In his own experience as a ‘decumulator,’ Por says he realized he had less assets than he thought when he decided to retire. He went to a number of financial institutions and couldn’t find the help he needed. They just offered to take his money, put it in a fund, and have him go away. He says this is all you can expect at the retail level.

He found this depressing, so he researched and analyzed the current retirement landscape to see what plan sponsors could do.

“We tend to forget this, but a pension plan is a vehicle that stretches out consumption over a lifetime,” he says. He was working at Mercer at the time the conversions from defined benefit to DC plans were starting and says no-one thought about the future and the decumulation phase.

DB plans offers a predictable income and a one-size-fits-all solution. Members do not have to worry about how to invest and measure the funds, he says. There is always professional management at low cost. If the assumptions don’t work out, the sponsors will pay the pensions anyway.

Por says if we were to design a DC plan today, we would set a goal and determine how to measure the success. We would determine the risks including lifestyle and longevity risks. Then we would buy something that guarantees a certain amount of income until we die.

During the accumulation phase, there are well-crafted, carefully selected options usually overseen by a consultant. The plan sponsor offers professional management. “There will be fiduciary supervision, a pension director, treasurer, consultant, governance consultant, institutional pricing. But, when it’s time to retire, DC plan sponsors give us a check and say thank you very much.”

MEMBERS DON’T KNOW

Members don’t know how much money they need, how to budget, or how to convert assets to income. Up until this point, they didn’t need to do anything.

In his research of 25 large Canadian plan sponsors and major DC consultants, Por found that all DC plan designs are basically vintage designs from the 1980s and 1990s. They had not thought of income. Only recently has he seen some new players emerging on the consulting side who are addressing this issue.

“Sponsors are still very reluctant to get involved in this process and we can spend a great deal of time on why that is and whether it is a good thing or not. Banks dominate this space at retail prices. After everything is said and done, retiring DC members are probably getting an income roughly 25 to 30 per cent less than they could have had if best practices were to apply to decumulation.”

ALTERNATIVE SOLUTIONS NEEDED

Por says the ideal DC plan is not going to come in the short-term. In the meantime, alternative solutions are needed.

At this time, options available to retirees have high fees and are not doing that good a job. “What do you think happens when something is very profitable and they are not doing a good job? Disruptions will be common,” says Por. “One thing we have to ask is ‘are we focusing on the customers’ real needs?’ Do we know what they should buy and do we offer that product?” He says very few organizations offer a unique value proposition with a unique product or better prices.

He says this is a complex and huge societal issue that involves approximately $2 trillion dollars converting from assets into income and we will experience disruptions in the form of new investment vehicles for this phase. At this point, there is a general reluctance to tackle it because the industry is structured in such a way that nobody has a vested interest in doing it better. Por says the key question is, who will provide the solutions? “Because right now we do not know.”

PLAN SPONSORS TO HAVE BIGGER ROLE

Recent legislative and regulatory developments suggest that plan sponsors may have a more proactive role to play with respect to communicating decumulation than was previously thought to be the case, says Jonathan Marin, an associate at Osler. At Benefits and Pensions Monitor’s ‘DC Plan Decumulation’ session, he said that there is also a value proposition for plan sponsors integrating effective decumulation strategies both into their DC plan design and into their member communication strategies.

“Decumulation is an area of pensions that is often overlooked,” he said. Overall, the health and sustainability of the retirement system in Canada has become a lively and politically contentious issue. We are faced with two key problems: there are not enough people participating in employer-sponsored pension plans and, for those that are, their current level of savings are showing to be insufficient to meet retirement needs. For employers to better balance pension risk with employee compensation and retirement savings goals, it may be achievable through finding new ways to maximize value within their existing DC plan designs. “I think this is where decumulation can play a pivotal role.”

Decumulation can, in many cases, have a greater impact on overall DC value than the accumulation phase, he says. However, the conversion of DC assets into retirement income is, for the most part, left up to individual retirees. Most DC plans require members to transfer their entitlements out at retirement, which is usually accomplished through one of two vehicles: a life annuity or life income fund/registered retirement income fund.
THE MISSING PIECE

“The problem with these options are they are generally offered at a retail or close to retail basis with high associated fees. When a plan member retires, they are no longer under the protective umbrella of the plan sponsor; they are individuals dealing directly with financial institutions without the requisite expertise to understand the risks associated with decumulation. The missing piece in many cases would seem to be the awareness of the positive impact that an effective communication or an effective decumulation strategy can have on DC plan value.”

Marin says there have been legislative reforms across the country that will permit the payment of variable DC benefits. There is a question as to whether sponsors would be willing to take advantage of this option, given there is a legal price that if you offered variable DC benefits, you will continue to have fiduciary obligations to plan members. At this point there are sponsors out there that are willing to explore and look into the possibility of paying variable benefits within their plan.

From a regulatory perspective, the key development has been the recent CAPSA policy. It is clear that pension regulators in Canada see communications relating to decumulation as forming part of an administrator’s fiduciary duties. In practice, this could mean that decumulation communications form part of a regulator’s pension audit process or it could even be the basis for fiduciary-based claims based on the duty of the communicator, says Marin. In terms of opportunities, DC plans designed to leave decumulation to individual retirees are potentially less valuable than DC plans which embrace decumulation on a group basis as part of an overall plan design in a retirement income plan objective strategy.

AN OPPORTUNITY

These developments provide an opportunity for plan sponsors to revisit elements of their plan design, which, in many cases, were developed before there was awareness of the decumulation issue and before options like variable DC benefits were available.

Marin asks, with the CAPSA Guideline #8 suggesting there is now an obligation to communicate with respect to the decumulation phase, will we see more pension litigation there is now an obligation to communicate with respect to benefits were available.

The proliferation of 401(k) litigation in the U.S. suggests there is now an obligation to communicate with respect to benefits were available. There are a number of factors to consider:

- enhanced awareness of decumulation
- a wave of baby boomers retiring from DC plans
- many DC retirees will have insufficient retirement savings

“When you take a look at the individual pieces, with some exceptions, they are not terribly complicated but, when they are taken all at once, it is just overwhelming,” he says. He has been in the business of helping people transition for 11 years and says it is painful to see these people struggling to come to grips with all of the issues that they have to be informed about and all of the decisions that they have to make. “They are very upset and nervous and the reason is that they are facing a massive amount of change. It is very stressful. They are facing a dramatic change in lifestyle and they are surrounded by a large number of trivial questions.”

He suggests plan administrators provide information to help members make informed decisions which strike a better balance between protection from the risks inherent in products available and achieving target replacement rates. He says risks include inflation, longevity, and sequence of returns – all beyond the control of the member. There are also risks with product or asset allocation, withdrawal rates, and healthcare costs which are all, to some extent, under the control of the plan member.

“Decumulation is a big, big problem,” Jack says. As an actuary, he calculated the number of Canadians between the ages of 60 and 71 for 2011, 2016, 2021, and 2026. “The size of that cohort between 2011 and 2016 grew by 17.5 per cent. From 2016 to 2021, it is going to grow by another 12 per cent. We are talking about big numbers. The need for education is vast and it will require vast resources from the financial services industries. Call centres are not going to cut it; there is a clear need for extensive group education and one-on-one counselling.

“I am absolutely appalled at the situation I find my clients in. The plan sponsors are not stepping up, and the plan administrators are not staffed to support the needs of these members. The members effectively find themselves in a vacuum. The situation is an unexpected consequence, in my opinion, of the shift from DB to DC plans. Nobody understood how complicated it was going to be for members to make their way through this transition out of a DC plan. There are thousands and thousands of people out there desperate for unbiased advice.”

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