Re-Defining Defined Contribution Plans

FEBURARY 2018

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With a growing number of Canadian employees facing a retirement funding shortfall, some plan sponsors have worked to enhance defined contribution schemes by adopting an "institutionalized" approach to plan construction.

Some 7 in 10 Canadian employees who belonged to a registered pension plan were enrolled in a defined benefit (DB) plan[1], one that guarantees workers a pre-determined payout at retirement irrespective of market fluctuations, often covered entirely by the employer. While Canada remains well ahead of the U.S. in terms of DB coverage (by comparison only five per cent of U.S. employers offer new hires traditional DBs, according to Willis Towers Watson[2]), in recent years these plans have gradually ceded ground to defined contribution (DC) plans, which are funded by payroll deductions and require workers to monitor their own investment choices. Thought to be less expensive and easier to administer as compared to DB plans, DCs nonetheless present some challenges. For one, DC plans traditionally tread lightly in the alpha-generating alternatives space; furthermore, final payout sums are unknown and can vary based on one's total contributions and investment performance. Additionally, employees with guaranteed, paid-in-full DB coverage may be reluctant to switch to employers offering DC plan benefits only.

Many believe that putting more of the pension burden on the employee could lead to a dramatic increase in the number of individuals with insufficient retirement funding, a trend that is likely to continue particularly as DC plan usage becomes more widespread. Employees themselves appear willing to take action: data from Willis Towers Watson found that nearly two-thirds would favour a larger payroll deduction in return for a fully funded retirement[3]. Accordingly, sponsors that can provide viable retirement plan alternatives may have an edge in terms of attracting and retaining employees over the long haul.

ENHANCING DEFINED CONTRIBUTION PLANS

With a growing number of Canadian Baby Boomers and Gen X'ers preparing to leave the workforce, as well as Millennials considering their retirement more closely, some plan sponsors have considered an "institutionalized DC" approach to help better equip their members for retirement[4]. This has included infusing DCs with DB-like attributes, such as offering lower-cost alternatives in place of conventional mutual funds.

Managing expenses is only part of the equation; boosting yield is another. Because DBs generally offer greater exposure to alternative investments, they have historically outperformed DCs (by as much as two per cent annually). In response, DC managers are

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increasingly looking to asset classes such as private equity, hedge funds, real estate and infrastructure in order to make up the difference. A Boston Consulting Group report found that roughly a third of the combined $1.1 trillion held through Canada's leading public pension funds was invested in alternative classes[5]. According to PwC's Global Hedge Fund Distribution Survey, in 2016 some 44 per cent of global hedge fund managers planned to launch new fund products. Additionally, over 80 per cent of those offering liquid-alternatives funds (which are typically void of incentive fees, redemption restrictions and other traditional hedge-fund constraints) expect further growth going forward [6].

While improved return on investment remains a priority for DCs, meeting elevated risk, transparency and governance standards has been no less important, particularly with regulators, board members and others seeking a clearer view into portfolio activity.

EMPLOYEE ENGAGEMENT

In an effort to boost participation and simplify investment choices, Canada's Pension Protection Act (PPA), enacted a decade ago, was designed to encourage the use of automation to help plan sponsors engage more of the workforce. However, a report by human resource solutions provider, Aon Hewitt found that some plan sponsors have yet to incorporate automatic enrolment[7], due in part to the higher administration costs but also the belief that mandatory payroll deductions for retirement could impact employee savings. Furthermore, auto-enrolment alone may not be enough to help employees close the savings gap, nor provide participants with a fully transparent retirement roadmap.

Offering DC-enrolled employees with guidance and information can, however, greatly improve the prospects for a successful retirement. As such, sponsors looking to better prepare their members can take additional steps such as providing employees with better insight into retirement planning, including targeting those deemed most vulnerable. According to a BNY Mellon report, nearly two-thirds of sponsors (63 per cent) indicated a commitment to helping workers maintain a disciplined approach to retirement, focusing not only on sound investing but also helping younger or lower-income workers develop better savings strategies, such as discouraging fund withdrawals or reducing regular contributions[8]. Sponsors are also investigating educational options, including providing access to advisors or education materials as part of their employee experience.

MAKING IT LAST

While Millennial workers have time to get themselves on track, Gen X'ers and especially Baby Boomers who are not actively saving for retirement are more likely to be forced to work well into their 60s or perhaps longer. Over half of Canadian employers expect that workers age 65 or older will account for at least five per cent of the workforce during the next five years, according to research by Aon Hewitt[9].

Sponsors are now looking at programs that will help their employees plan for their future while working but also during the decumulation phase post-retirement. Programs are coming to the market that provide plan members with access to holistic financial planning beyond just their DC benefit. These programs assist the plan member through both the accumulation and decumulation phases of the plan.

As pension sponsors implement their plan design and investment choices, CIBC Mellon can help support plan sponsors through a wide range of pension trust fund structures and plan benefit disbursement solutions. Our teams work closely with our clients to help make sure that manager and account structure changes are well supported and executed.

STRUCTURED FOR LIFE

With the right guidance, information and decisions to help workers successfully bridge the retirement gap, DC employees can set themselves up well for retirement. Having said that, with healthier lifestyles and economic conditions, employees are likely to remain in the workforce much longer as compared to previous generations. This compels sponsors and member stakeholders to focus on providing added clarity, including improved reporting and better income calculators, to help make sure plan participants have an adequate income stream at retirement. Plan sponsors are likely to seek greater efficiencies through outsourced administration and investment functions, while others may consider joining forces with larger pension entities. Finally, increased emphasis on socially responsible investments, including environmental, social and governance factors (ESG), is also expected to continue, particularly as tools that facilitate greater clarity around such strategies become widely available to plan fiduciaries.

As pension sponsors implement their plan design and investment choices, CIBC Mellon can help support plan sponsors through a wide range of pension trust fund structures and plan benefit disbursement solutions. In particular, through the use of a pension trust for DC assets, CIBC Mellon can assist DB/DC sponsors who are looking to extend their DB investment model to their DC members. Many plan sponsors have the structure and knowledge in place to manage this type of arrangement, and it can provide an alternative to a traditional DC insurance model. CIBC Mellon offers its expertise to assist clients in setting up their DB or DC accounting structures, whether they be domestic or global, pooled or segregated, stand-alone accounts, or master trusts for the assets of several plans. Our teams work closely with our clients to help make sure that manager and account structure changes are well supported and executed.

CIBC Mellon's Pensioner Information Network (PIN) platform provides sponsors and their consultants with direct access to pensioner information, combined with robust security and lump sum payment validation procedures.

The majority of existing DB plan participants are experienced employees, with new hires primarily being offered DC enrolment instead. This growth is driving the development of DCs with DB-like attributes.

Hybrids like target benefit plans, which offer DB-like features, such as actuarially based funding to achieve a projected retirement payout, at a reduced cost to employers, can help mitigate some of the uncertainty associated with conventional DC plans, and are therefore well worth sponsors' consideration.

Through the use of a pension trust for DC assets, CIBC Mellon can assist DB/DC sponsors who are looking to extend their DB investment model to their DC members.

For More Information

CIBC Mellon works continuously to meet the evolving needs of plan sponsors and their stakeholders. The company has more than two decades of experience supporting Canadian pension plans through its pension benefit services and services to pension trust funds. Contact your CIBC Mellon Relationship Executive or Relationship Manager to learn more.

About CIBC Mellon

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For more information visit www.cibcmellon.com.

Notes:

1 Statistics Canada: Pension Plans in Canada, July 2016 (http://www.statcan.gc.ca/daily-quotidien/160721/dq160721d-eng.htm)

2 "A Continuing Shift in Retirement Offerings in the Fortune 500," Willis Towers Watson, February 2016 (https://www.towerswatson.com/en-US/Insights/Newsletters/Americas/insider/2016/02/a-continuing-shift-in-retirement-offerings-in-the-fortune-500)

3 "62% of Canadians would pay for better retirement benefit: survey" Benefits Canada, June 2016 (http://www.benefitscanada.com/news/62-of-canadians-would-pay-for-better-retirement-benefit-survey-83132)

4 "The DC Plan of the Future," BNY Mellon, May 2016 (https://www.bnymellon.com/_global-assets/pdf/our-thinking/dc-plan-of-the-future.pdf)

5 "Canada pension funds pull back on infrastructure as prices climb," Reuters, February 2016 (http://www.reuters.com/article/canada-pensions-infrastructure-idUSL2N15G2Q4)

6 PwC Global Hedge Fund Distribution Survey 2015 (http://www.pwc.nl/nl/assets/documents/pwc-distribution-disrupted.pdf)

7 Aon Hewitt Pulse Survey: "The Impact of Automatic Enrollment," January 2015 (http://www.aon.com/attachments/human-capital-consulting/pulse-impact-of-automatic-enrollment.pdf)

8 "The DC Plan of the Future," BNY Mellon, May 2016 (https://www.bnymellon.com/_global-assets/pdf/our-thinking/dc-plan-of-the-future.pdf)

9 "Delayed Retirement," Aon Hewitt, July 2016 (http://www.aon.com/canada/attachments/human-capital-consulting/news_AH_Over_65_Benefits.pdf)

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