

The First Step To Maximizing DC Plan Value Is To Understand The Problem



These days when people who work in the pension industry talk about the various options available to develop an effective pension risk management strategy, they are fond of pointing out that when it comes to looking at the range of plan design options, the discussion is about a lot more than traditional defined benefit (DB) versus defined contribution (DC) arrangements. Increasingly, plan sponsors are expressing interest in considering target benefit/shared risk plan (TBP) alternatives to the extent such arrangements are, or appear soon to be, authorized under enabling legislation in their pension jurisdiction.

The legislative changes to date to accommodate TBP alternatives should be applauded – in the right circumstances, conversion to a TBP can be beneficial for all stakeholders involved. (For more information on TBPs, see our prior posts: “The ABC’s of Target Benefit Plans” Part I, Part II and Part III, and “C.D. Howe Paper: Target Benefit Plans in Canada – An Innovation Worth Expanding”.) However, TBPs are not intended as a “one size fits all” pension risk management solution and may not be a viable option for all employers and their employees. For some employers, a better “balancing” of pension risk with employee compensation and retirement savings goals may be achievable through finding new ways to maximize value out of their DC plan design.

In a four part blog series, we will first examine various ways in which the “traditional” accumulation driven DC plan design fails to maximize value (Part I) and then explore methods to increase DC plan value and ensure compliance with administration best practices (Parts II, III and IV).

Confronting the Issues in An Employer’s Existing DC Plan Design

Apart from setting contribution levels and trying to educate members on how to create winning personal investment strategies, it is often the case that too little thought is given to ways of maximizing DC plan value. As a DC plan sponsor/administrator, the first step forward may be to ask yourself the following questions:

- Are you missing low cost ways to enhance the value of your DC plans and increase member appreciation of these plans’ true potential?
- Could your plan do more to encourage employees to participate and maximize their contributions?
- Is there more that you could do to communicate the value of your DC plans to

your workforces?

- Should you (and your record keeper delegates) be doing a better job developing effective communication programs to prepare members for important decumulation decisions as they approach retirement?

By designing and administering their plans to focus exclusively on the DC accumulation phase, many sponsors/administrators would likely answer "YES" to one or more of these questions.

As John Por (of the Decumulation Institute) points out in his recent August 2014 article in *Benefits and Pensions Monitor*(p.12):

Today DC plans are thought of merely as saving plans and not as retirement income generators. This is a serious issue as approximately 60 cents of every retirement dollar will come from returns earned after retirement. Without addressing the cost-effective conversion of assets into income (i.e., decumulation), the danger of significantly lower retirement incomes looms large.

For a variety of historical reasons, most DC plans are designed to deal with what happens over 35 to 40 years of employment, but not the next 20+ years following retirement. Ironically, this 20+ years of decumulation can in many cases have a greater impact on overall DC value. Despite this fact, the conversion of DC assets into retirement income is, for the most part, left up to the retiree on the theory that such conversion can be done cost efficiently through individual efforts and "practical, cost-effective and transparent products and services" readily offered by financial institutions and intermediaries. However, achieving this in today's market, given longevity risks, investment product fee structures and most individuals' lack of financial/investment experience, may be a tall order for the average DC pensioner.

The result – DC plans designed to leave decumulation up to individual retirees are potentially much less valuable than DC plans which embrace decumulation on a group basis as part of plan design and overall retirement income objectives. Addressing this undervaluation may provide plan sponsors with a more attractive DC plan for workforce recruiting and retention, in addition to improving plan governance for plan administrators.

In Parts II, III and IV of this blog post series, we will further examine methods to increase DC plan value and for plan administrators to ensure compliance with best practices.

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