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CAP To The Future:

Decumulation In CAP Plans

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Private sector companies have shown increasing interest in capital accumulation plans (CAPs) for a number of years and CAP assets under management continue to grow. Currently, most retirees of such plans transfer their account balances, tax-sheltered, to individual decumulation products which, in most cases, do not provide optimal results. In recent years, however, legislative changes have been adopted to allow group decumulation options for CAPs.

The decumulation landscape in Canada is evolving rapidly as it gains recognition not just as an effective way to improve retirement outcomes for CAP participants, but as a fundamental step forward in the direction of improved wellbeing for CAP participants at all stages of the journey to retirement.

What is decumulation?

From a member's perspective, the problems to be solved and the support available to solve them during the accumulation phase and the decumulation phase couldn't be more different.

Throughout the accumulation phase, members are offered best-in-class institutional investments, highly competitive fees negotiated by the sponsor for the program that leverage the asset size of the group, and leading edge tools, call centre support, and in-person education to support informed decision making.

Decumulation is far more complex a problem to solve as members exit the program and navigate their myriad sources of retirement income. The task of co-ordinating an optimal withdrawal strategy that considers tax efficiency, market risk, annuity features, inflation protection, and, of course, the unpredictability of how long they may require their pension income to last is not insignificant and has often been described as the nastiest problem in finance.

How is decumulation done today?

The options that Canadians have today to withdraw income from their CAPs at retirement are:

- Life income funds (LIFs) and registered retirement income funds (RRIFs)
- Variable benefits – Similar to the group LIF/RRIF, but the retirement income is withdrawn directly from the defined contribution (DC) plan
- Annuities

A plan sponsor that is considering offering a decumulation solution to members today may offer either a third-party LIF/RRIF or a branded solution via a company-sponsored group LIF/RRIF or variable benefits solution.

Company-sponsored decumulation solutions have several significant advantages over offering a third-party solution.

First and foremost, there is a trust factor that exists between employees and their employer when it comes to the delivery of retirement programs. Endorsement and encouragement from the plan sponsor for members to consider the pros and cons of the decumulation feature is valuable.

Furthermore, benefits of low fees and continued access to the program's tools, support channels, and investments, as well as the continued governance processes adhered to by the plan sponsor, are key for participants to understand and appreciate the decumulation feature.

Are new solutions on the horizon?

Yes, many other articles have been written about the advanced life deferred annuity (ALDA) and variable payment life annuity (VPLA), both announced in the 2019 Federal Budget. Both are highly anticipated.

Until longevity pooling within a CAP framework such as a VPLA is within reach, sponsors are making great strides forward in the quest to provide improved decumulation guidance

for members. The performance of longevity studies on CAP populations and statistics-based persona development are leading to more refined, timely, and relevant support tools for members to guide them to better decisions for themselves and their families. A few examples of growing interest include increased literacy and support via retirement spending modelling, the evaluation of CPP/OAS deferral opportunities, annuities or advanced life deferred annuities, investment strategies for different spending patterns, and tax effective asset withdrawal.

Dispelling the common myths about sponsored decumulation programs

No discussion of the merits of decumulation is without its challenges. The most common that bear some reflection are:

This sounds expensive – This is not necessarily true in all cases and depends on the characteristics of the program and its population, just as those are cost drivers for the accumulation phase of a retirement program. In fact, to the contrary, there are often significant savings to be generated in overall investment management fees that benefit not just the retiring members, but for the entire membership as a whole.

This sounds like too much work – Often, the same sound frameworks that plan sponsors have effectively put in place to govern their CAPs during accumulation are highly leverageable and extendable to the decumulation phase.

This sounds like I will need to keep track of retirees – While true, it is also something that administrators are well-equipped to do and, in fact, do already when terminated and retired members exit company sponsored programs for the third-party product offerings.

This sounds like an increase in fiduciary risk – Chief Justice Beverley Marian McLachlin said this about fiduciary risk: "The essence of a fiduciary relationship is that one party exercises power on behalf of another and pledges himself or herself to act in the best interests of the other." In pondering this statement, there is room to consider that the introduction of program features that will produce better retirement outcomes for participants is an action that is indeed in the best interest of members. An improvement in outcomes for all could conceivably even reduce the risk of challenge from program participants whose retirement assets might otherwise fail to support their lifestyle spending in retirement.

Several hundred plan sponsors in Canada today are already offering their own sponsored decumulation features to plan participants and many are reporting positive results with member engagement and appreciation of program value better aligned with their intended purpose to deliver retirement outcomes with maximum efficiency.

FAST FACTS

- *More than 90 per cent of clients surveyed believe decumulation is an important wellness strategy*
- *More than 85 per cent of clients surveyed believe programs with decumulation can deliver better retirement outcomes than those without*
- *Fewer than 10 per cent of clients surveyed believed the challenges of decumulation outweighed the advantages*
- *More than 70 per cent of clients surveyed believe decumulation options make programs more competitive*
- *More than 90 per cent of clients surveyed believe the number of CAPs with decumulation in Canada will increase over the next 10 years, with some indicating it will become the new norm*

How can decumulation features optimize the efficiency and value of a CAP?

Improving the efficiency of a CAP (i.e. driving greater dollars of retirement income for every dollar of contribution by either the sponsor or the participant) is a worthy pursuit with compelling results.

Setting aside the benefits of enabling individuals to access the same caliber of investment managers in both the accumulation and decumulation phase, and focusing strictly on the savings in fees during decumulation that can be achieved versus retail fees, the impact on retirement outcomes is significant. Consider, for example, that a fee savings of 1.5 per cent per year during decumulation could result in the same improvement in retirement outcome that could be achieved by a 35-year-old who was contributing 12 per cent to their CAP today, increasing their annual contributions by two per cent more every year until 65 (or an additional four per cent every year for a 45-year-old, or as much as an additional 11 per cent per year for a 55-year-old). These levels of fee savings are achievable and impactful.

The benefits that an employer can gain from providing support to plan members as they transition to retirement are significant. Plans with decumulation features are more likely to be seen as true retirement programs rather than mere savings accumulation vehicles and are becoming more critical to sponsors attracting and retaining the talent needed by their businesses. Paternalism may be outdated, but evidence shows that caring companies attract a higher-quality workforce. Offering retirement support will not only help employees feel less stressed, but also help them be more productive and feel like a valuable asset to the company.

What may be less obvious, but equally important, is that decumulation features have a significant role to play in the quest for achieving financial wellbeing for not just retiring members, but for the entire plan population. Active employees also benefit from decumulation features with the knowledge and improved confidence that they will receive a pension from the program and be supported throughout the retirement journey. Well-supported decumulation programs, through a variety of means including unbiased advice, communication, and dedicated retirement option websites and customized retirement income simulation tools, like the Cumulus tool we have built at Morneau Shepell, can help steer members in the right direction and help them achieve financial wellbeing.

Fundamentally, we believe that the good that comes with offering decumulation features and support for both participants of all stages and for the business itself far outweigh challenges that can be managed. Primarily, we believe that CAPs could and should deliver pensions and not just accumulated assets. We see their ability to do so as a critical and anchoring component of a financial wellness program and, indeed, for workforce total wellbeing.

This is the future we hope to see for CAPs and their members. **BPM**

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