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Why DC plan sponsors should care about decumulation

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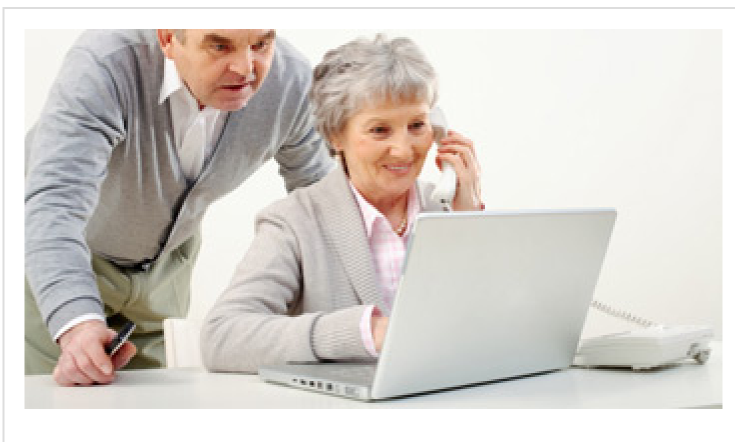

Rivers of ink have been spilled over how to help DC members to save more, invest better and gain more knowledge. We have applied behavioural economics, calculated the effect of high fees on cumulative savings, taken advantage of the latest research on heuristics and employed the best consulting talent—all to ensure that the accumulated savings will prove adequate in achieving DB-like replacement ratios.

But what we've kept silent about is what happens to those assets at retirement. This is ironic since, according to Don Ezra's *The Retirement Plan Solution,* 60 cents of every retirement dollar is funded by returns earned after retirement—twice as much as the combined impact of all returns before retirement (the remaining 10 cents is the combined employer and employee contributions).

So, clearly, decumulation matters. But when it comes to discussing it, the conversation awkwardly stops. HR and pension professionals—who serve as dedicated, hard-working guides in leading their DC plan members to the summit of the savings mountain—find it discomfiting to be reminded of what happens on the other side.

You may find it shocking that the recordkeeping industry estimates that about 80% to 90% of all Canadian savings slated for retirement outside of DB plans is turned into income at retail prices, without professional portfolio management considerations. Further estimates suggest that the resulting retirement incomes are 20% to 30% less than what they *could have* been, if institutional fees and proper fiduciary oversight were applied.

So why is there such a void when it comes to decumulation? There are a few reasons. First, employers did not really think through what their hands-off attitude actually meant for members' income, and prevailing legal advice often urges employers to keep clear of extending what could be considered fiduciary obligations after retirement. Also, our attitudes toward DC plans were formed many years ago, at a time of high expected rates of return and low DC knowledge, so income considerations at potentially low interest rates were not a concern.

The usual rationale for the lack of sponsor involvement is that paternalism is a thing of the past, and competitive pressures are forcing companies to be flexible. This is true as it goes—but then why do we call DC plans "pension plans"? And, as we already provide support on the way up the mountain, why wouldn't we on the descent—especially when we know it is much harder and far more dangerous?

Why should you, as a plan sponsor, be concerned about decumulation for your DC plan members? Let's consider a few thought experiments.

1. If a company found out that the DB pension cheques it sent out were 20% to 30% less due to a flaw in the administrative system, even if it could not be held legally responsible, would it just stand idly by?
2. Would corporate executives who have spouses, children, friends and relatives in DC plans wash their hands of their relatives' fate if they were told that, with a bit of adroit tinkering, their retirement incomes could be dramatically improved with almost negligible additional fiduciary risks?
3. Is it good for productivity if employees in the last 10 years of their careers are worrying about their financial security in retirement?
4. Do companies really want 67- to 72-year-old workers on their payroll who are only there because they can't afford to retire?
5. If retirees really do suffer from the effects of inadequate income (due to insufficient savings, poor spending habits, loss of income due to high fees or inefficient decumulation products, etc.), are corporations better positioned than the government to help them to turn savings into incomes, at a lower societal cost?
6. Are retirees considered good business assets as consumers, goodwill ambassadors and a talent pool for emergencies and recruitment, rather than a burden to be left behind?
7. Is the concept of helping employees to convert their hard-won assets at fair prices the "right thing" to do?

Of course, none of this means that DC plan sponsors should rush headfirst into taking on onerous and risky obligations. It only means that the same caring HR executives who designed and put in place effective DC savings programs should present these concerns to their fellow business and financial colleagues to make an informed decision on whether—and how—they wish to constructively deal with these issues on their members' behalf.

Right now, executives may not understand what they do not want to get involved in, let alone the financial consequences of such aloofness.

Paternalism may be a thing of the past, but evidence shows that caring companies attract a higher-quality workforce. Given that attraction and retention of employees will be a major emerging issue, HR executives have a vital role to play—not only in the lives of their retirees, but also in making their corporation a winner in the coming war for talent.

John Por is founder of the Decumulation Institute. The views expressed are those of the author and not necessarily those of Benefits Canada.

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