DC Decumulation

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Agenda

- **CAP Landscape**
  - Global Trends
  - Shifting Focus to Decumulation
  - Demographics of Aging Population
- **ACPM Decumulation Paper**
  - Background
  - Key Risks
  - Decumulation Options in Canada
  - Recommendations
- **Experience in Other Countries**
  - US
  - UK
  - Australia
  - Netherlands

Capital Accumulation Plan Landscape

Global Trends

- DC will remain the dominant global retirement savings mechanism
- Many countries are reforming pension systems including:
  - Shifting focus to CAPs (DC, GRRSP, DPSP, TFSA, non-reg)
  - Increasing coverage (auto enrollment, auto escalation)
  - Improving security for pension savings (locking-in, other)
  - Focus on decumulation
- Shifting risk to individuals requires strengthened regulatory framework (OECD Principles) and national financial literacy strategies
- Increasing DC prevalence requires renewed focus on plan design to support adequate retirement income (OECD Roadmap)
- Individual member decision-making requires better support; need to address advice gap
- Review country-specific tax legislation
- Consider unified pension systems

Source: *OECD Pensions Outlook 2016*

CAP Landscape—Shifting Focus to Decumulation

Plan design changes:

- Automatic enrollment
- Automatic escalation of contributions
- Default investment options in decumulation period
- Variety of decumulation options (internal and external)
- Effective communication to and through retirement
- Member education—shift to provision of limited advice

CAP Landscape—Shifting Focus to Decumulation (continued)

Needed regulatory changes in Canada:

- Pension legislation in all jurisdictions should allow variable benefits
- Tax legislation changes focussed on DC:
  - Enable variable pay life annuities
  - Increase mandatory pension commencement date
  - Reduce minimum withdrawal limits (to enable flexibility)
  - Increase TFSA limit (other side of the tax system!)

Initiatives and advocacy efforts increasing:

- OECD Principles and Roadmaps
- ACPM
- PIAC
- CAPSA

CAP Landscape—Shifting Focus to Decumulation (continued)

What is a Good Retirement Goal?

"An inflation-protected income for life that allows you to sustain the standard of living you enjoyed in the latter part of your working life."

Source: Robert Merton, Professor of Finance at MIT Sloan School of Management (speaking at 2017 DC Summit in Vancouver, BC)

CAP Landscape—Shifting Focus to Decumulation (continued)

How is this Approach Different?

	Conventional Approach	New Approach
Investment goal	Wealth accumulation *No specified wealth goal*	Retirement income *Specified desired income goal*
Risk measure	Volatility of portfolio returns	Volatility of funded ratio *Income shortfall*
Success measure	Account balance size	Funded ratio *Relative to desired income goal*
Asset allocation strategy	Generic proportions *Fixed or age-only based*	Dynamic individualized *Based on age, income, funded ratio. Focused on improving funded ratio while managing income volatility*

Source: Robert Merton, Professor of Finance at MIT Sloan School of Management (speaking at 2017 DC Summit in Vancouver, BC)

CAP Landscape—Shifting Focus to Decumulation (continued)

Post-Accumulation Flexible Spend-Down Strategies

These four components can be customized to individual needs

1

Guaranteed income for life

- Annuity
- Age Pension
- DB Pension

2

Conservative draw-down (minimum-risk income)

- Not guaranteed
- No longevity protection
- Provides liquidity
- Room for bequests

3

Desired income growth goal

- Targeted increase in income starts at specified date in retirement
- Invest in risk asset

4

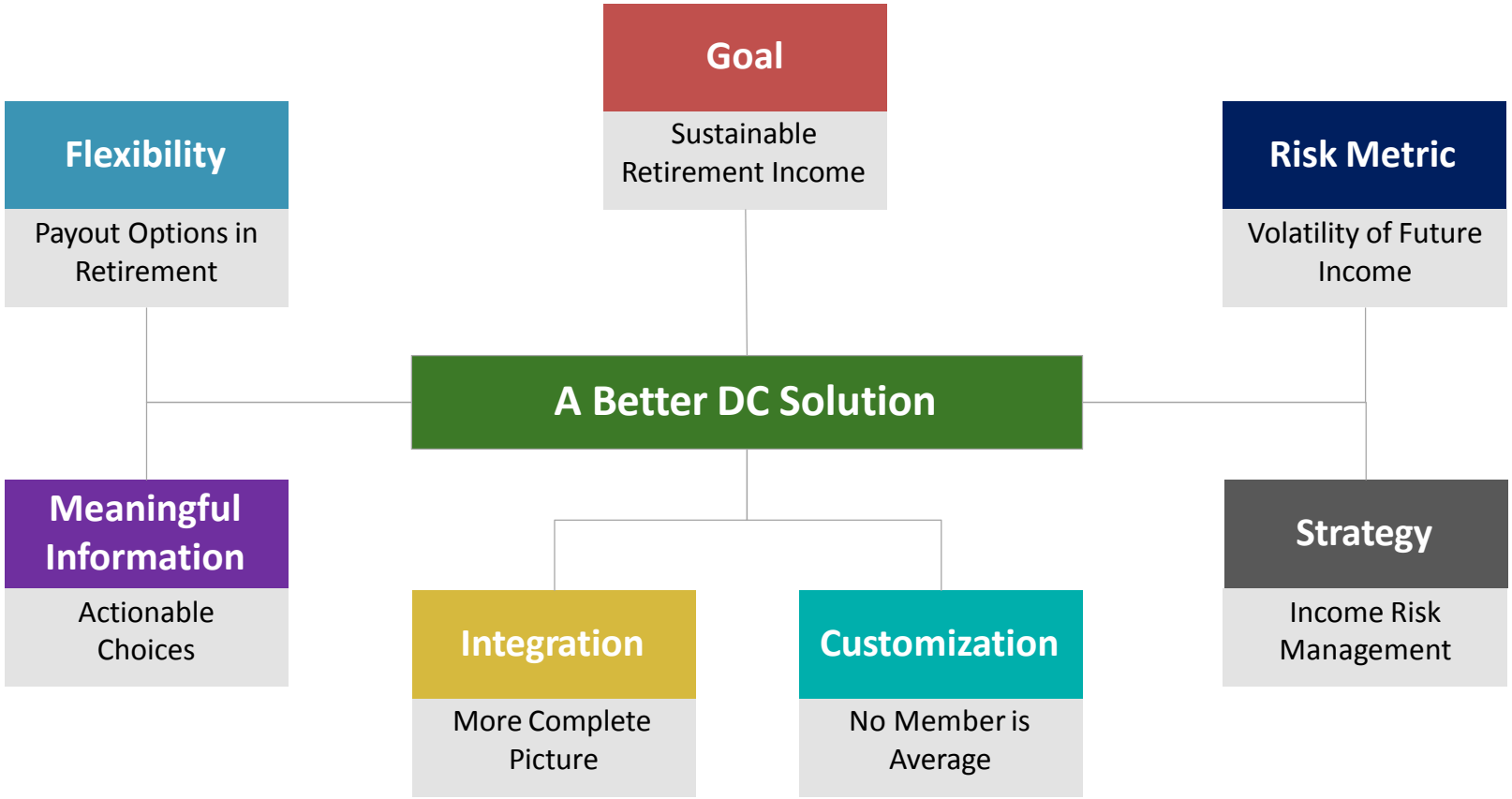
Longevity insurance

- Deferred annuity

Source: Robert Merton, Professor of Finance at MIT Sloan School of Management (speaking at 2017 DC Summit in Vancouver, BC)

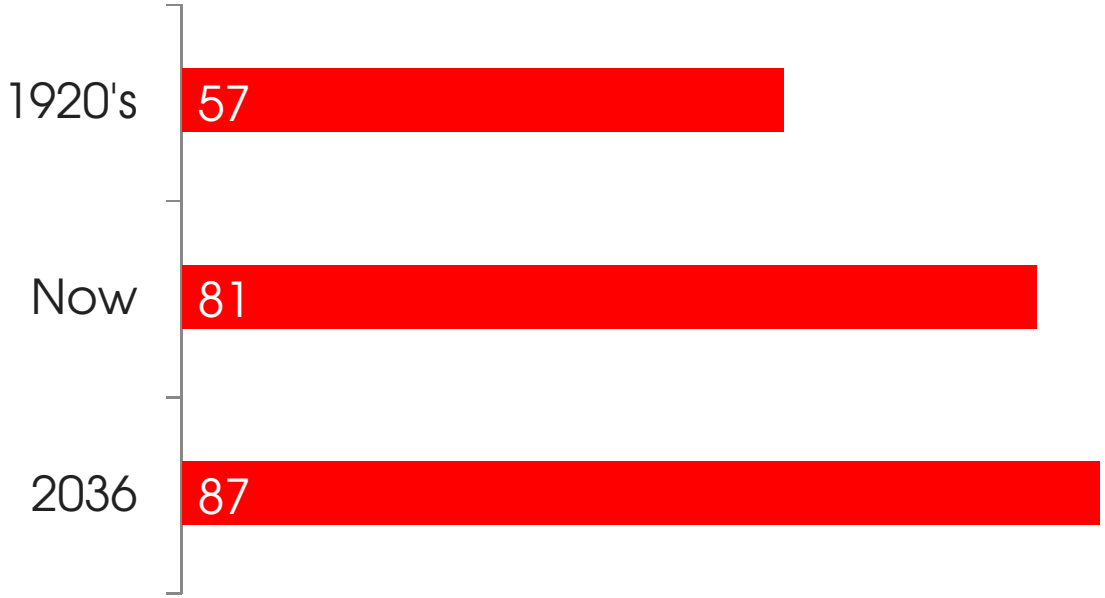
CAP Landscape—Shifting Focus to Decumulation (continued)

Key Features



CAP Landscape—Demographic Information on Aging Population

Average Lifespan of Canadians



Source: Dr. Darrell Bricker, CEO Ipsos Global Public Affairs (speaking at 2017 DC Summit in Vancouver, BC)

CAP Landscape—Demographic Information on Aging Population (continued)

Number of Canadians **Aged 100+**

7,900

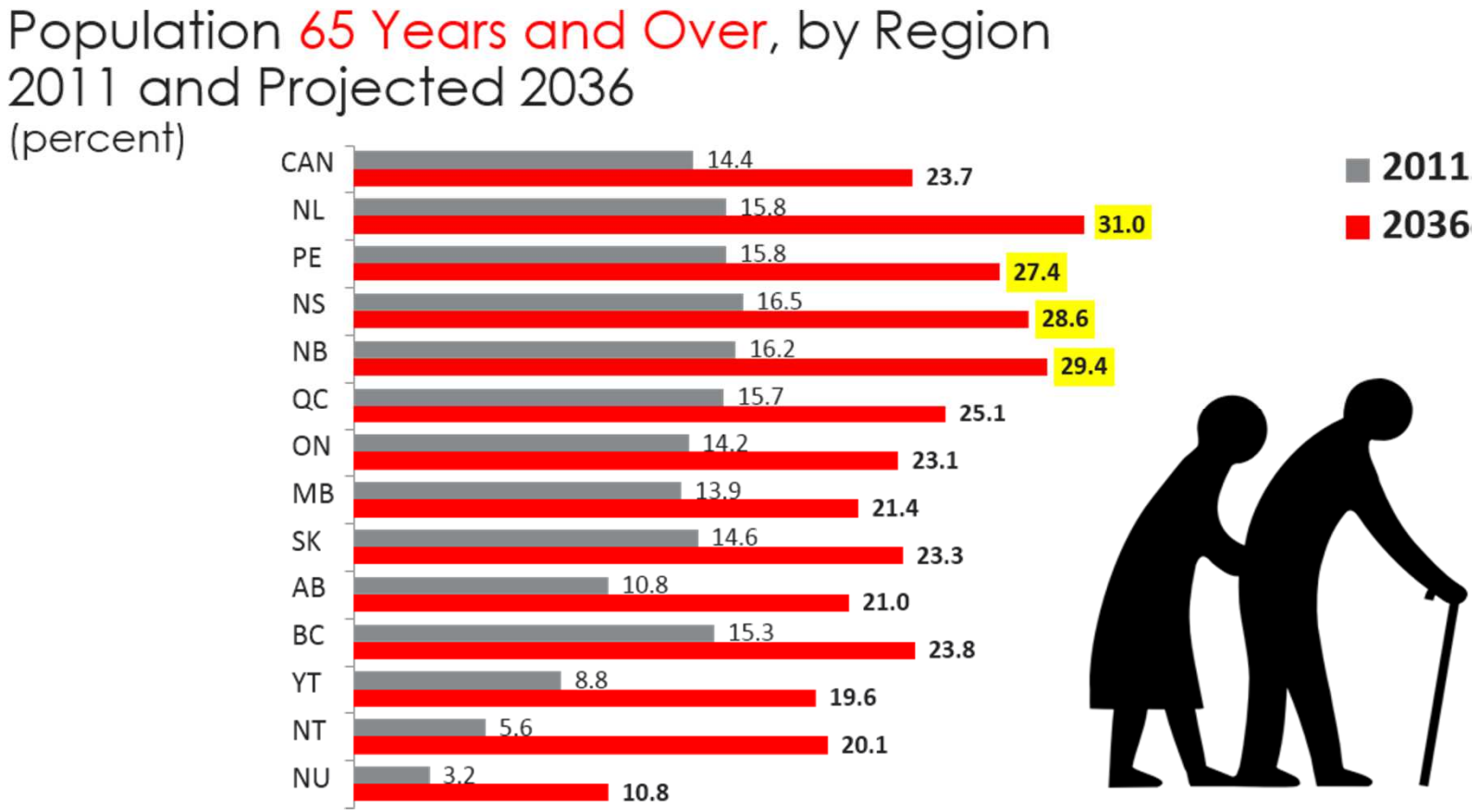
- By **2061** this will climb to

78,300

- *—more than P.A. and Moose Jaw Combined*.

Source: Dr. Darrell Bricker, CEO Ipsos Global Public Affairs (speaking at 2017 DC Summit in Vancouver, BC)

CAP Landscape—Demographic Information on Aging Population (continued)



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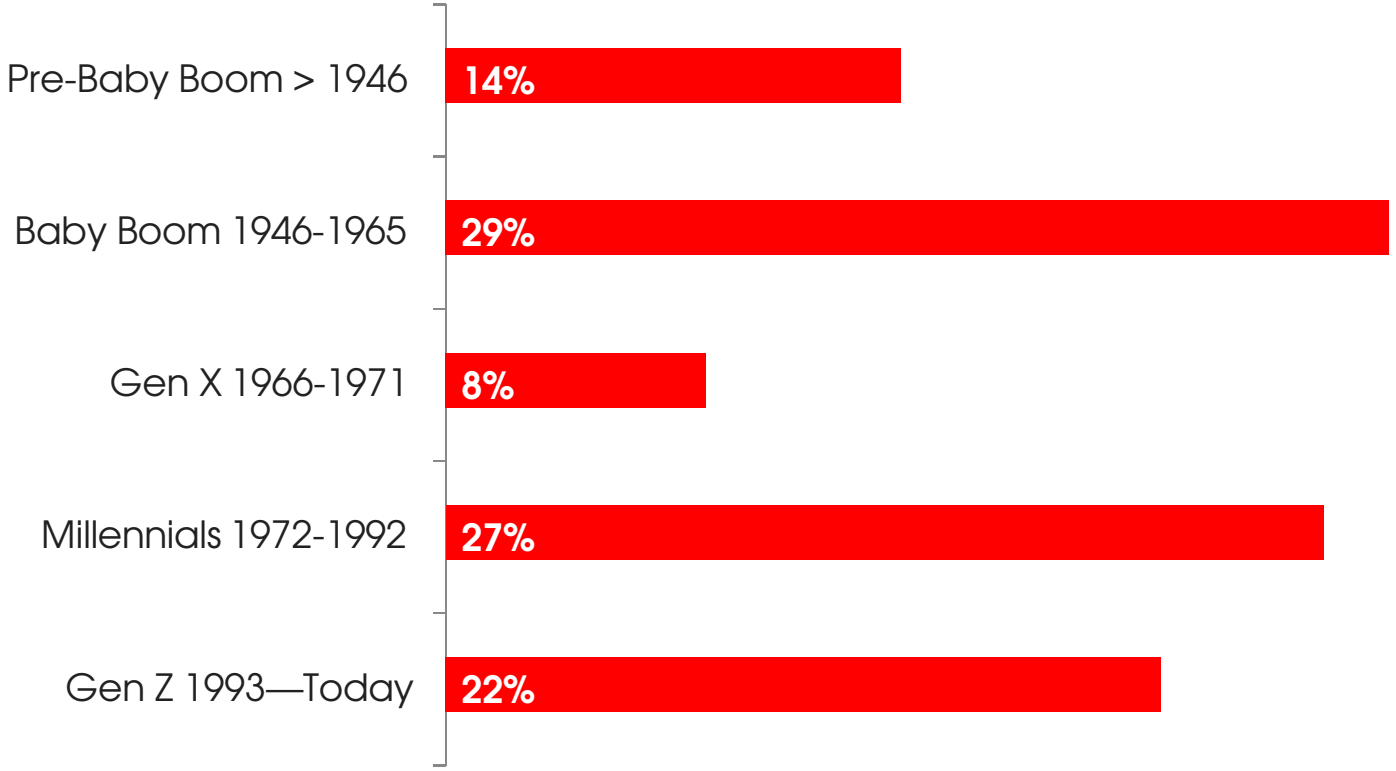
CAP Landscape—Demographic Information on Aging Population (continued)

Canada's Generations



Source: Dr. Darrell Bricker, CEO Ipsos Global Public Affairs (speaking at 2017 DC Summit in Vancouver, BC)

Discussion

How do your Organizations Compare?

ACPM Paper on DC Decumulation

“Decumulation, The Next Critical Frontier: Improvements for Defined Contribution and Capital Accumulation Plans”

Published March 27, 2017

ACPM Paper—Background

- Significant efforts over 20 years to support members during accumulation
- Discussions in many countries about decumulation of retirement savings
- CAP sector in Canada maturing
- Need to focus on member support during decumulation period
  - Decisions more complex
  - Help manage longevity and investment risk
- Most retiring Canadians roll CAP savings into individual products that:
  - Do not pool investment and longevity risk
  - Do not realize economies of scale
  - Do not offer simple investment menus with limited choice and appropriate defaults

ACPM Paper—Background (continued)

- Previous limited attention on decumulation issues and risks
  - Tax rules and pension standards do not encourage / permit employers to provide variable benefits within employer sponsored plans
  - Many employers reluctant to remain involved after end of employment
  - Popularity of CAPs began during periods of high returns and high long term interest rates—decumulation risks much less onerous than today
- Concern that CAP retirees left to deal individually with complex risks and retirement decisions will experience sub-optimal outcomes

ACPM Paper—Risks Transferred to Members

- Types of risks requiring support or mitigation
  - Interest rate risk
    - Volatility and fund exhaustion
    - Annuity costs
  - Inflation risk
    - Loss of purchasing power over time
  - Sequencing risk
  - Longevity risk
  - Agency Issues

ACPM Paper—Risks Transferred to Members (continued)

Sequencing Risk

- Prevalent under LIFs/RRIFs where there is flexibility in amount and/or timing of withdrawals over retirement period
  - Most retirement planning tools use average return assumptions
  - Do not demonstrate the uncertainty or risk produced by the random nature of the annual returns that make up the average
  - Where regular withdrawals are taken, below average or negative returns early in the sequence have a reverse compounding effect.
  - Unless spending is subsequently reduced or stopped, this can cause the CAP balance to become depleted more quickly than projections based on the average return would suggest.

ACPM Paper—Risks Transferred to Members (continued)

Longevity Risk

- The holder of an individual registered plan takes the risk that their funds will run out before they die.
  - partially mitigated by maximum withdrawal limits[1] applied to LIFs under provincial pension legislation
  - no maximum withdrawal limits for non-locked in[2] funds.

1. All provinces except SK have legislated maximum annual withdrawal limits that increase with age, designed to ensure some funds will remain to age 90 or later in some jurisdictions.
2. AB, MB, ON and Fed Govt permit 50% of locked-in pension funds to be unlocked at retirement. In MB, unlocked funds must be transferred to a prescribed RRIF; in Ont and federally, the entire DC balance must be transferred out of the plan before funds can be unlocked.

ACPM Paper—Decumulation Options in Canada

Individual Decumulation Options

- **Annuities**
  - Guaranteed income for life, but generally inflexible
  - Transfer investment and longevity risk to insurer
  - Cost based on rate at retirement; can seem prohibitive in low interest rate environment
  - Limited market
  - Most do not protect against inflation risk
  - No ability to leave “residual” to beneficiaries

ACPM Paper—Decumulation Options in Canada (continued)

LIFs/RRIFs/PRIFs

- Flexible, but funds can be exhausted
- Broad investment choice exposes retirees to investment risk and volatility
- Sequencing risk
- Longevity risk—partially mitigated by prescribed withdrawal limits
- Agency issues—misalignment of interests of advisor and investor
- Costs higher than fees within a CAP

ACPM Paper—Decumulation Options in Canada (continued)

Group Decumulation Options

- Limited internal retirement income options
  - Variable benefits not allowed in all jurisdictions
  - Internal annuities restricted by tax legislation
  - Some employer reluctance to continue relationship after retirement
- Some CAPs offer Group LIF/RRIF through plan service provider
  - Can offer same lower cost investment options as during accumulation
  - Familiarity and convenience is advantage to retirees
  - Fiduciary responsibility for oversight of decumulation options
- Group annuities are another external decumulation option

ACPM Paper—Decumulation Options in Canada (continued)

- Three large mature self- or co-administered plans in Canada offer broad decumulation options
  - PEPP, CSS, UBC Faculty Plan
  - PEPP and CSS are multi-employer so employer reluctance does not apply
  - UBC grandfathered under ITA
- ACPM DC Decumulation committee spent some time reviewing these to see what could be learned from their experiences

ACPM Paper—Decumulation Options in Canada (continued)

CSS:

- Dec 1939: formed
- 1970's: offer internal annuities due to elimination of Gov of Canada annuities
- Grandfathered under ITA so can continue to offer.
- Communication focuses on benefit of guaranteed lifetime income
- Also irreversibility of annuity purchase, and inability to leave residual to estate
- 2006: Added Variable Benefits
  - Few members currently combine variable benefits and annuity at retirement
  - Many start with variable benefits and annuitize balance when older
  - No risk pooling
  - Lots of communication on risk is provided
- CSS is looking into:
  - variable annuities (SK leg doesn't allow right now)
  - provide deferred annuities to 80 or 85

ACPM Paper—Decumulation Options in Canada (continued)

PEPP

- Has offered decumulation options for 40 yrs
- SPAF (Sask Pension Annuity Fund) since 1985
  - Annuities offered within PEPP prior to that
- One of the first Pension Plans to offer variable benefits
- Default investment:
  - Lifecycle fund (PEPP Steps)
  - Goes through to age 80 (reduces risk in 12 steps)
- PEPP Guidance:
  - Helps members decide on withdrawal rates and spending
  - “Retire@Ease”: proprietary retirement planning tool available after retirement
    - Emphasizes benefit of combining decumulation options
- Education / communication about financial and retirement planning starts while active, well before retirement

ACPM Paper—Decumulation Options in Canada (continued)

- **UBC Faculty Plan**
  - Has internal and external decumulation options
  - Internal:
    - Variable Pay Life Annuity
    - Internal RRIF- and LIF-type options
  - External:
    - LIRA/LIF for locked in funds
    - RRIF/RRSP/Cash for non locked-in funds
    - External life annuity purchase
  - Members in VPLA option clearly understand risks and accept variability
  - Strong communication efforts and member services support

ACPM Paper—Decumulation Options in Canada (continued)

- **UBC Faculty Plan Member Support**
  - Online retirement income estimator
    - Pension projections, variable benefit illustrations, VPLA illustrations
    - Internal member services specialists
    - Retirement planning workshops
    - Individual consultations
    - Other online and in-person member services through UBC and Sun Life
      - Moved to co-administration in 2015

ACPM Paper—Decumulation Considerations

- Risk tolerance changes after retirement
  - Investment options need to be reviewed / revised
- Additional administrative responsibilities
  - Retirees may need assistance to set withdrawal amounts
  - Calculation of legislated minimum and maximum limits
  - Post-retirement death benefits
- Litigation issues
  - Balancing spending decisions with investment experiences
  - Managing longevity risk

ACPM Paper—Decumulation Considerations (continued)

- CAP retirees require payment guidance and investment advice.
  - What standard will apply?
  - Who will pay advisers and how?
- How do you reduce employer / provider reluctance to maintain a relationship with plan members after retirement?
  - Multi-employer retirement plan designs?
- Are safe harbours needed?
  - Would best practice decumulation guidelines be better?
- Is it possible to follow some of the international examples and create multi-component, risk pooled decumulation defaults?
  - What legislative changes are needed?

ACPM Paper—Recommendation

- Multi-component, multi-employer, risk-pooled default decumulation options should be developed and offered through individual and group plans
- Include:
  - managed withdrawals
  - limited access to lump sums
  - longevity pooling through deferred annuities
  - opportunity to elect inflation protection
- Group self-annuitization products (e.g., uninsured variable annuities) should also be encouraged
- Changes required to pension and tax legislation
  - ACPM ITA subcommittee

What Legislative Changes Are Needed To Provide Better Decumulation Outcomes?

- Equalizing the taxation of DC and DB pension income
- Group self-annuitization (e.g. uninsured variable annuities)
- Encourage provinces not yet permitting variable benefits to move forward
- Open up ITA restriction to allow in-plan variable annuities
- Permit deferred annuities after age 71—perhaps with age and capital limits
- Safe harbours or other fiduciary protection—if seen as desirable

Experience in Other Countries

Each Country is Different

Country	Lifetime Annuities	Income Drawdown	Lump Sums
Australia	Allowed, but very little demand	Allowed. Main options are account-based income streams	Allowed and relatively common
New Zealand	Allowed, but there are no annuity providers in New Zealand	Allowed	Allowed and relatively common
USA	Allowed, but demand is weak. 9% of retirees have significant annuity income	Allowed	Allowed
Canada	Allowed, with significant demand	Allowed, although with restrictions in some cases	Limited for DC pension schemes
Ireland	Required, unless income can be shown to the above threshold to qualify for income drawdown	Allowed given sufficient income	Restricted to 25% or 1.5 times income as tax-free lump sum (taken by most people)
Switzerland	Default option, and subsidised	Not allowed	Allowed, but discouraged
Denmark	Unlimited deferred annuities	Restricted amounts can be allocated to term annuities	Allowed
Netherlands	Mandatory	Not Allowed	Not Allowed
Singapore	Mandatory	Not Allowed	Not Allowed
Chile	Default Option	Restricted to 'programmed withdrawals'	Not Allowed
UK	Formerly primary option. Allowed	Currently restricted to 'capped drawdown' and 'flexible drawdown'' products.'	25% tax-free, taken by most people. Expected policy is for whole pot to be available, taxed at marginal income tax rates after 25% tax-free allowance

Source: *UK Financial Conduct Authority: The Retirement Income market—comparative global research*

Takeaways

Takeaways

- Consider default decumulation option
- Focus on outcomes and not wealth accumulation
  - Consider alternate “guidelines” for adequate income measurements
- Continue to monitor trends and developments (Canada and global)
- Sequencing Risk
  - Should be focus of modelling and member communications
- Retirees presentation
  - Focus on retiree-specific engagement and ongoing communications