

# Defined Contribution Issues (plan fees, decumulation, etc.)

IAA and IPEBLA Joint Colloquium  
June 26 – 29, 2016



# Agenda

- Legislation/Guidelines
- Issues galore!
  - Conversions
  - Contribution levels
  - Investment choices
  - Member communications
  - Member behavior
  - Fee disclosure and oversight



# Legislation/Guidelines

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- Legislative provisions
  - Fiduciary obligations. For e.g. the Ontario Pension Benefits Act s. 22 (1) duty to “exercise care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.”
  - Federal provisions re. DC Investments – will be discussed on a later slide.

# Legislation/Guidelines

- Canadian Association of Pension Supervisory Authorities (CAPSA) Guidelines
  - CAPSA Guideline No. 3 - Guidelines for Capital Accumulation Plans
  - CAPSA Guideline No. 8 - The Defined Contribution Plans Guideline
- Other guidelines are also relevant but not directly with DC



# Issue: Conversions to Defined Contribution

- Past conversions
  - Possibility of litigation, years or even decades, after the effective date of the plan amendment
    - › For e.g. triggered by post retirement situation where members see the impact of difference between DC and DB benefits
  - Possibility of review by a regulator or court at a later date



# Issue: Conversions to Defined Contribution

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- Past conversions continued...
  - Recent case: NCR Canada Ltd. v. Local 213 of the International Brotherhood of Electrical Workers British Columbia Labour Relations Board August 22, 2014
    - › Employer sponsored a DB pension plan for quite a number of years, and then decided to introduce a DC component which would apply to all new employees, and current employees who opt in
    - › Employees told if they chose to remain in the DB plan, they would remain DB for the rest of their employment with the company

# Issue: Conversions to Defined Contribution

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- Past conversions continued...
  - 19 employees chose not to opt in
  - Issue to be decided was whether the employer could later require the nineteen employees who opted to remain in the DB plan to participate in the DC plan post conversion
  - Arbitrator found the company could not require the nineteen employees to participate in the DC plan
  - Decision upheld by BC Labour Relations Board on appeal

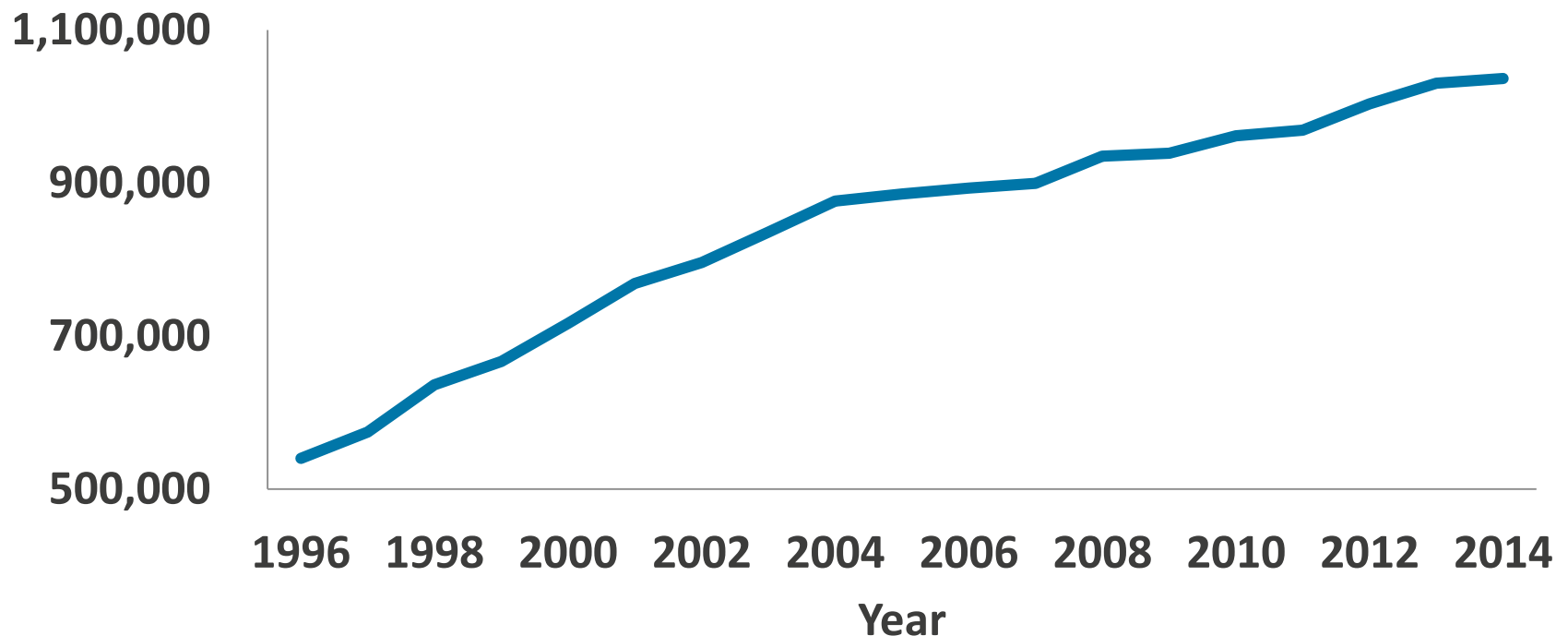
# Issue: Conversions to Defined Contribution

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- Future Conversions
- Communications present a risk
  - Minimize future oriented statements or predictions in advance of a conversion, including statement about what will happen to the DB plan
  - Note plan text provision concerning the right to amend/terminate the plan may not be sufficient to address future claims



# DC Plans in Canada



- There are now more CAPs than DB plans in Canada
- 23% of workforce will retire within 15 years; 1,000 Canadians a day

# Issue: Contribution levels

- The Canadian requirements
  - Federal Income Tax Act minimum:
    - › 1% of employer's payroll
  - Federal Income Tax Act maximum:
    - › lesser of \$26, 010 (2016 year) and 18% of the member's compensation



# Issue: Contribution levels

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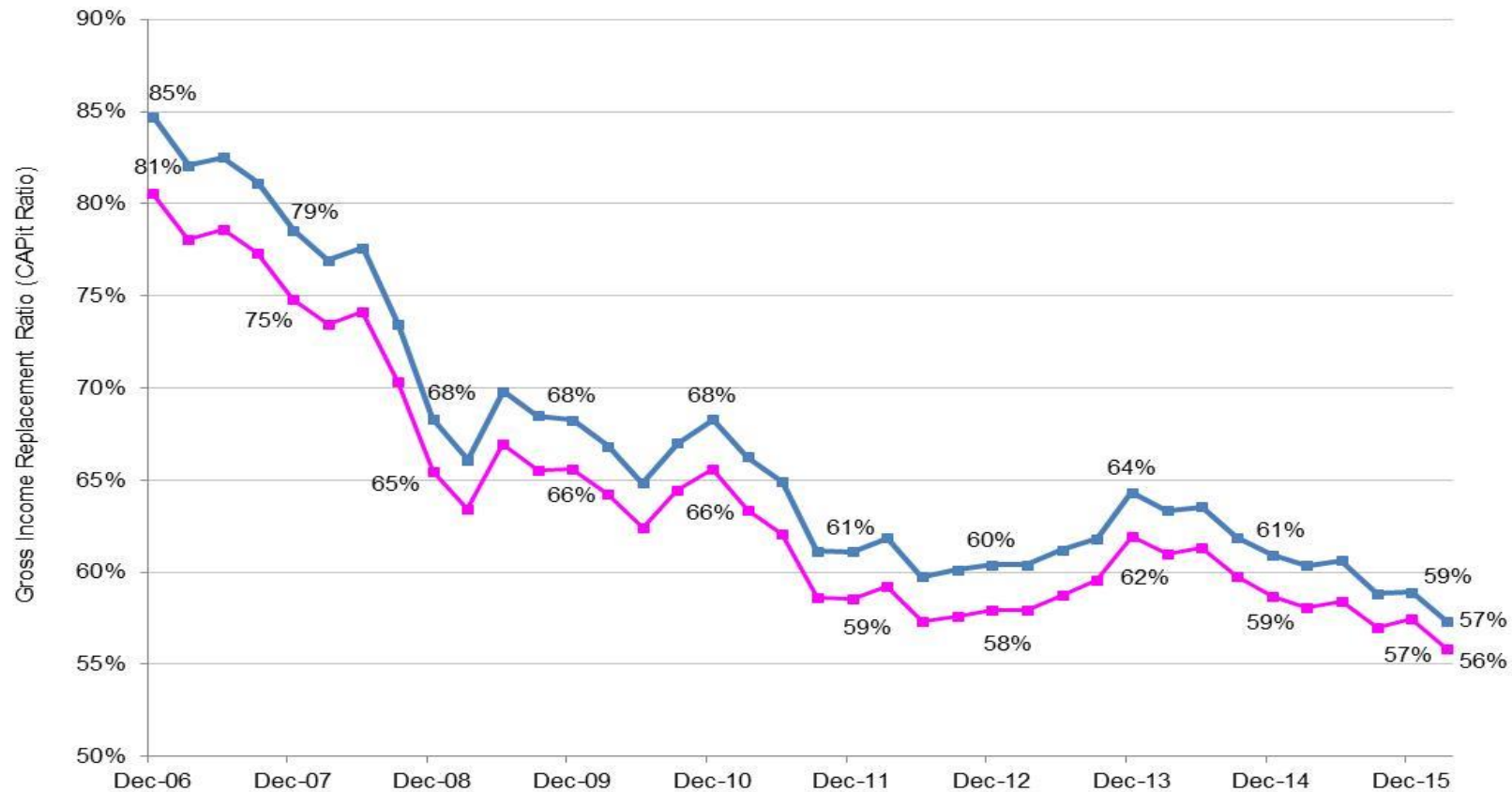
- Plan terms
  - Employer/sponsor discretion for contributions above the minimum
  - Members may or may not be required to contribute
    - › Members may have the option to make additional voluntary contributions above the required contribution

# Issue: Contribution levels

- Sufficiency of contributions
  - What constitutes an appropriate contribution rate
    - › Purpose of the plan
    - › Open question in Canada. No reported decisions on issue of sufficiency of contributions - possible to see when boomers retire if less than expected
    - › Higher rate not necessarily always beneficial, for e.g. for members who earn a low income:
      - reduce much needed take-home pay
      - limited tax deferral advantage; likely already in lower federal and provincial income tax bracket
  - ORPP requires 8% contribution (at least 4% employer) to be considered a comparable plan

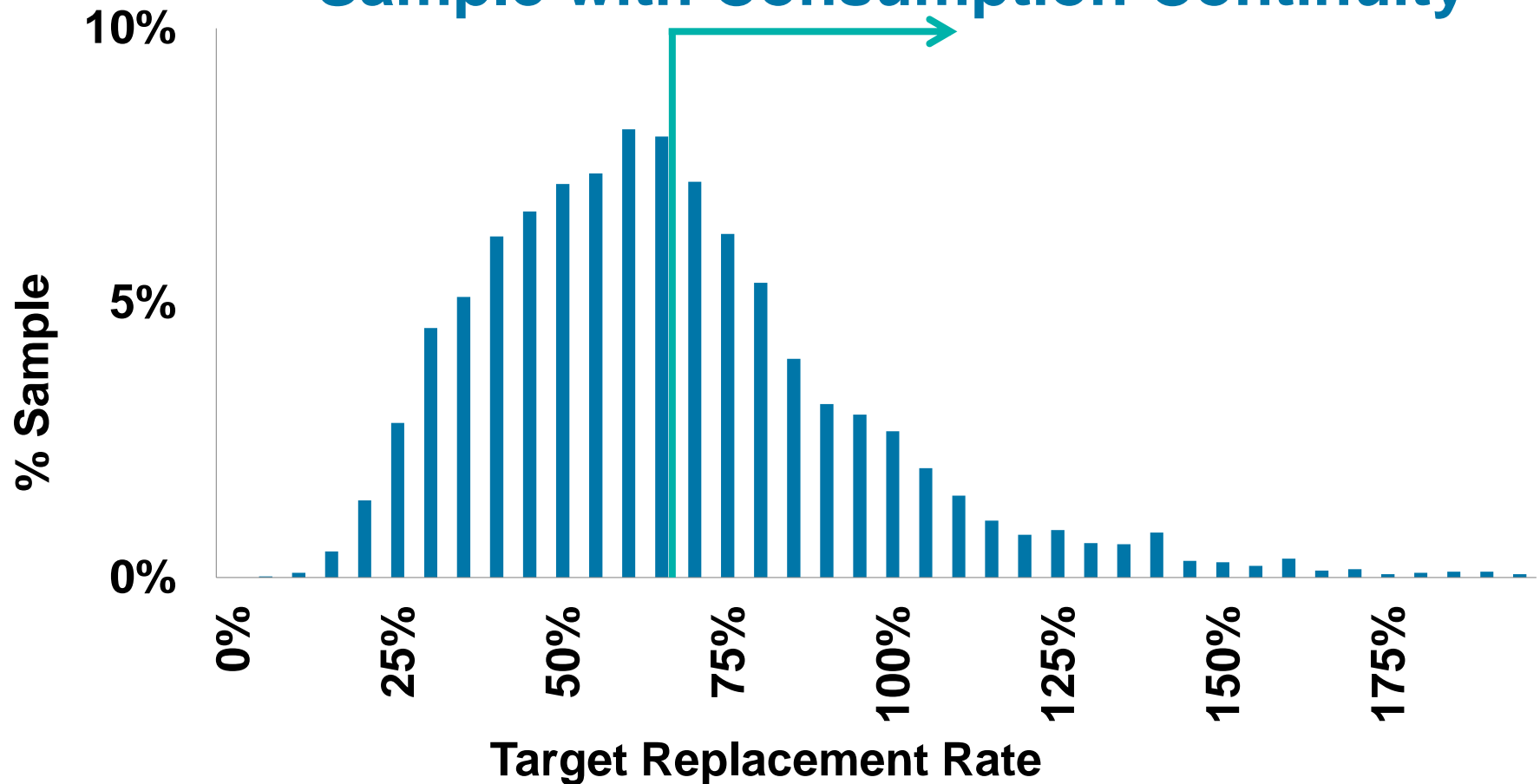
# Hard to generate income

## CAP Income Tracker



# New way of thinking

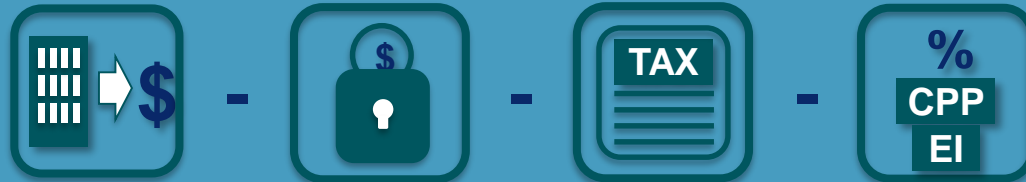
## Sample with Consumption Continuity



# Unique target for each individual

## Living Standard Replacement Ratio™

Pre-  
Retirement  
Net Income



Post-  
Retirement  
Net Income



Personal  
Factors



# Living Standard is key



## Year **1974**:

- Single earner household
- Head aged 40 (born 1934)
- 5 dependents < 18 yrs old
- Household disposable income: **\$120,000** (2015\$)

**Same**  
standard of  
living



## Year **2015**:

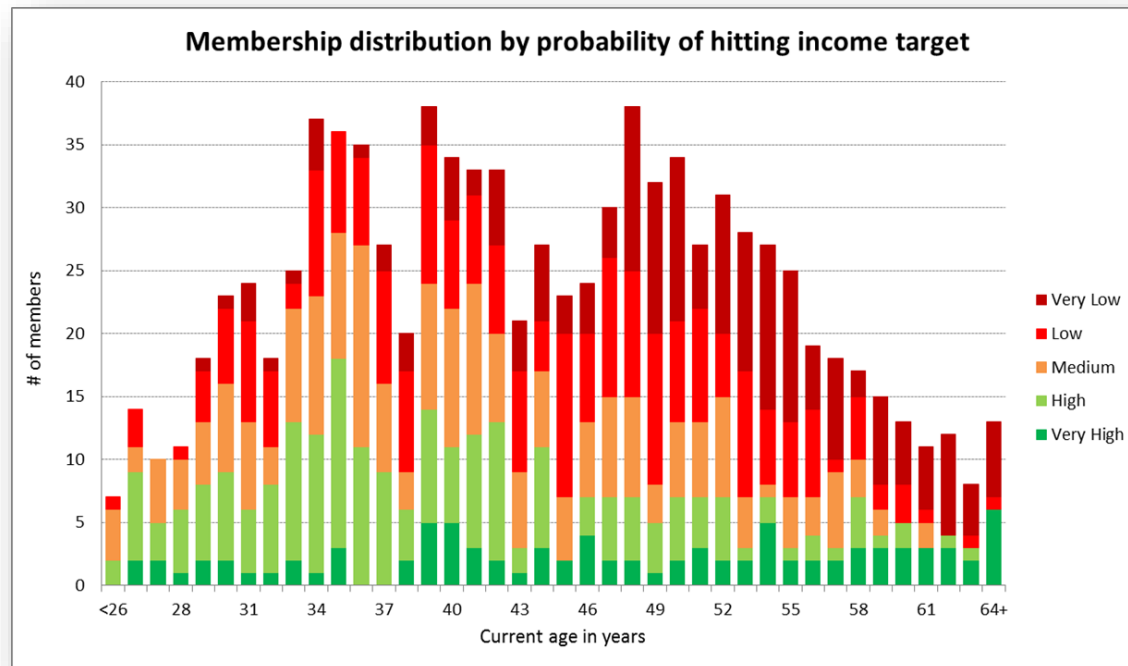
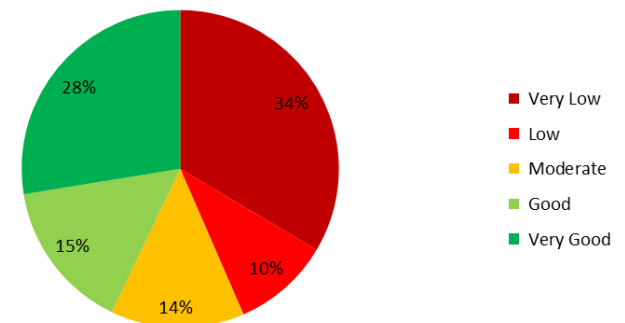
- Single earner household
- Head aged 81
- No dependents
- Household disposable income: **\$50,000**



# Understanding retirement outcomes

	Contribution		
Sample employee - full career	4%	5%	6%
Joins at Age 30, \$40K per year; 2050 Fund	Good	Good	Very Good
Sample employee - mid career	4%	5%	6%
Joins at Age 40, \$40K per year; 2040 Fund	Moderate	Good	Very Good

Membership distribution by probability of hitting income target



# Why adequacy is important

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- Workforce planning
- Litigation risk
- Headline risk

# Issue: Investment choices

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- Investment choices - two approaches:
  1. Administrator retains full responsibility for investment of member accountsOR
  2. Administrator offers menu of investment options (life cycle, target date, etc.) and provides information and programs to members who decide how to invest their DC accounts
    - › Note plan administrator retains responsibility for selecting the menu of investment options, including default
    - › Note fees may be charged directly to individual accounts and directly borne by members

# Issue: Investment choices

- Is one approach better?
  - Less risky? Less onerous to administer?
  - No legislative direction on what approach is best
  - Some jurisdictions address duty of administrator when selecting menu of investment options:
- Federal Pension Benefits Standards Act s. 8 (4.3)
  - “If a pension plan permits a member, former member, survivor or former spouse or former common law partner of a member or former member to make investment choices, the administrator must offer investment options of varying degrees of risk and expected return that would allow a reasonable and prudent person to create a portfolio of investments that is well adapted to their retirement needs”.

# Issue: Investment choices

- British Columbia Pension Benefit Standards Act, s.68 (4) (a)

“Subject to subsection (6), if the plan text document of a pension plan provides that a member must provide direction regarding investments, the administrator must ensure that

- a) members are offered a sufficient number of investment options of varying degrees of risk and expected return that would allow a reasonable and prudent person to create a portfolio of investments that is appropriate for retirement savings, and
- b) a plan document provides that one of the following default investment options applies to the account of a member who fails to provide direction regarding the investments:
  - i. a balanced fund;
  - ii. a portfolio of investments that takes into account the member's age.”

# Issue: Investment choices

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- No real 'safe harbour' in legislation
- CAPSA Guidelines neutral on whether administrator should retain responsibility or offer member choice
- With respect to member choice, CAPSA Guidelines offer limited guidance:
  - Factors plan administrator should consider when selecting investment options: purpose of plan, number of options to be made available, associated fees, diversity and demographics of members
  - Sufficient information on investments so members can make informed decisions: options, fees, transfers, default option applicable if no member instructions are provided
  - Range of decision making tools for members: retirement planning tools, calculation and projection tools, investor profile questionnaires

# Personalization of DC Investments – Pre TDF

Single  
Balanced  
Fund

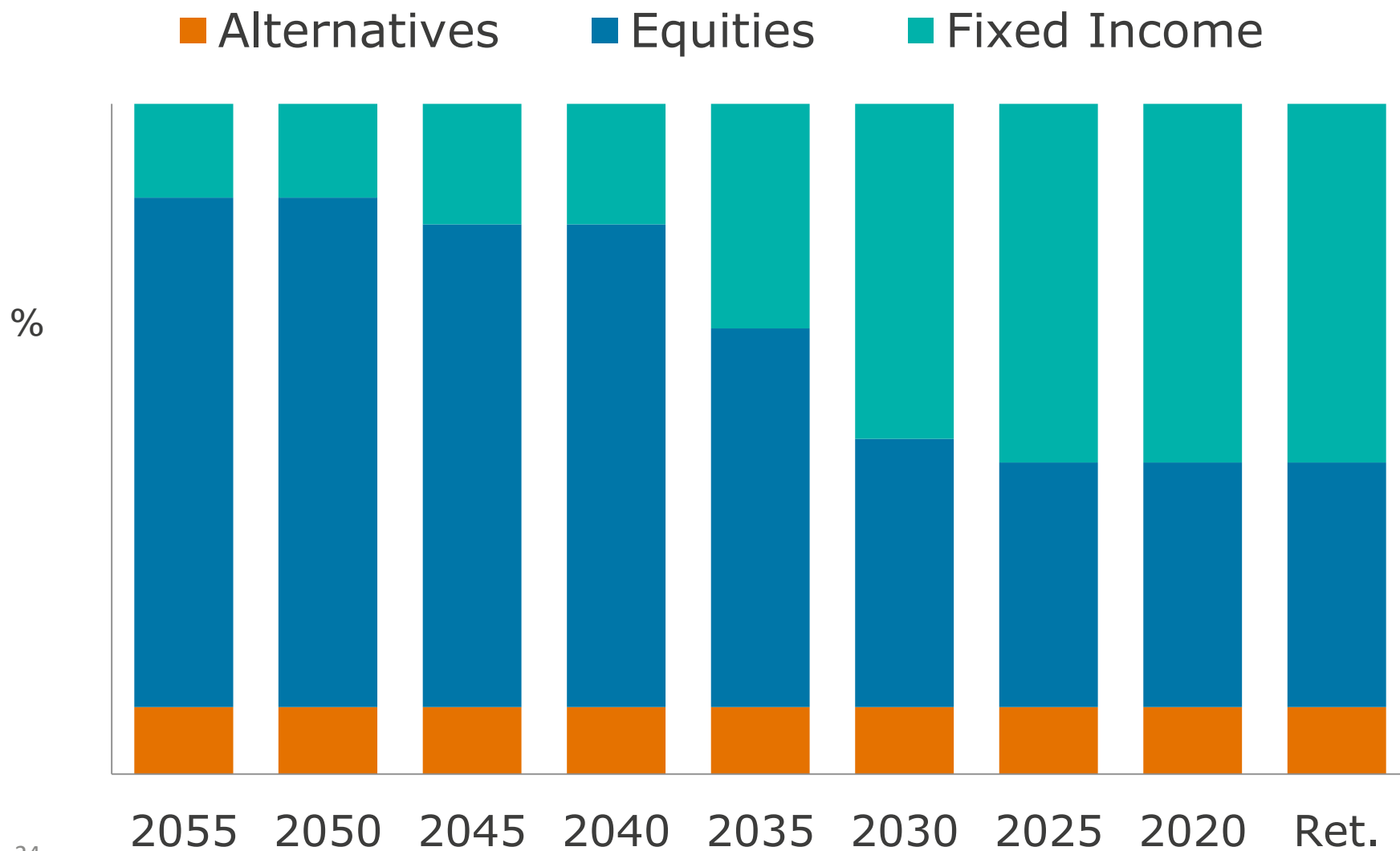
Target  
Risk  
Funds

À  
La  
Carte

*Less personalized*

*More personalized*

# Target Date Funds





# Customizing TDFs by Plan

**Pooled TDFs**

**Customized TDFs  
(Plan)**

***Less personalized***

***More personalized***

# Customized TDF's Gaining Traction

**We have already  
implemented a custom  
TDF solution**

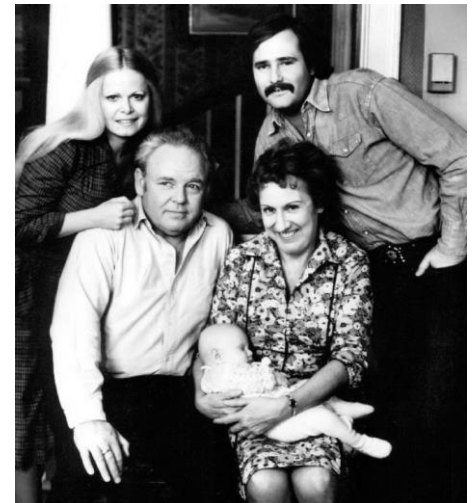
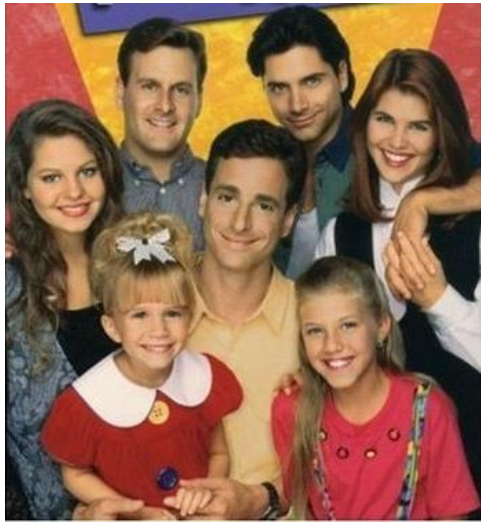
**22%**

**We can see the added  
value of a custom TDF  
solution**

**27%**

**49%**

# Does one solution fit all?



# Personalizing Target Date Funds

Pooled TDFs

Customized TDFs  
(Plan)

Individual TDFs

***Less personalized***

***More personalized***

# Issue: Member communications

- Misleading communications
  - Future claims of negligent misrepresentation
  - Carefully qualify all statements related to projected account balances
- Monitoring third party administrators
  - Legal “administrator” ultimately retains responsibility to ensure communication responsibilities are met
- Communicating member responsibilities
  - Contribution amounts, selecting investments, if applicable
  - Obtaining investment advice
  - Member responsibility notice



# Issue: Member behavior

- Measuring engagement/understanding
  - May need to be addressed with specialised communications
- Default option - member directed accounts
  - Obtain reports on member participation in the default fund
  - Know whether members defaulted or self-selected default option
  - Identification of a beneficiary





# Issue: Fee disclosure and oversight

- Duty of openness and candour
  - Little guidance regarding disclosure on fees in Canada
  - Significantly less litigation than in the US
  - Bank of Montreal Trust Company case (LIRAs)
    - › A preview?
    - › Alleged breach of fiduciary duty to account holders by profiting from foreign currency conversion charges which were not disclosed or necessary
- Duty to monitor agents
  - Review fee levels and question amounts
  - See opportunities to negotiate for lower fees



# Issue: Fee disclosure and oversight

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- CAP Guidelines:
  - Provide a description and amount of all fees, expenses, or penalties relating to the plan that are borne by members:
    - › For e.g. fund management fees, fund operating expenses, record keeping fees, service provider fees
  - Where appropriate fees, expenses and penalties may be disclosed on an aggregate basis:
    - › Fees incurred due to member choices, such as transfer fees or for use of investment tools should not be aggregated



# U.S. – Litigation and Regulation

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## **DC Litigation Escalates**

- 2006 LaRue v. DeWolffe Decision
- Brightscope
- Schlicter Firm, Settlements, and Common Claims
- Employer Responses and Precautions

## **Department of Labor Rulemaking**

- Fee Disclosure Regulations
- Fiduciary Rule

# Decumulation

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- Boomers about to leave plans
- Have accumulated under a DC context for better part of career
- Challenges – everyone wants the assets, sponsors shy of responsibility... finding unbiased advice, deciding whether to support members and for how long
- Affects investment offering considerations in plan and plan fees

# Current Canadian guidance

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- CAPSA Guideline No. 8:
  - Information about regulated retirement products (LIRAs, LIFs, annuities)
  - Information on available unlocking options
  - Information to assist informed member decisions “which strike a balance between protection from risks inherent in the various products and achieving target replacement rates”

# Retirement is Complicated

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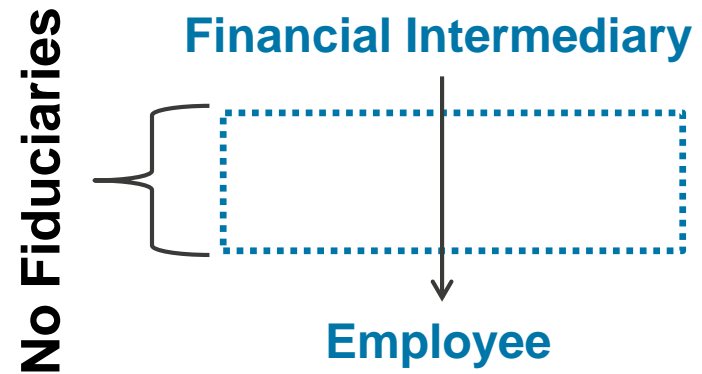
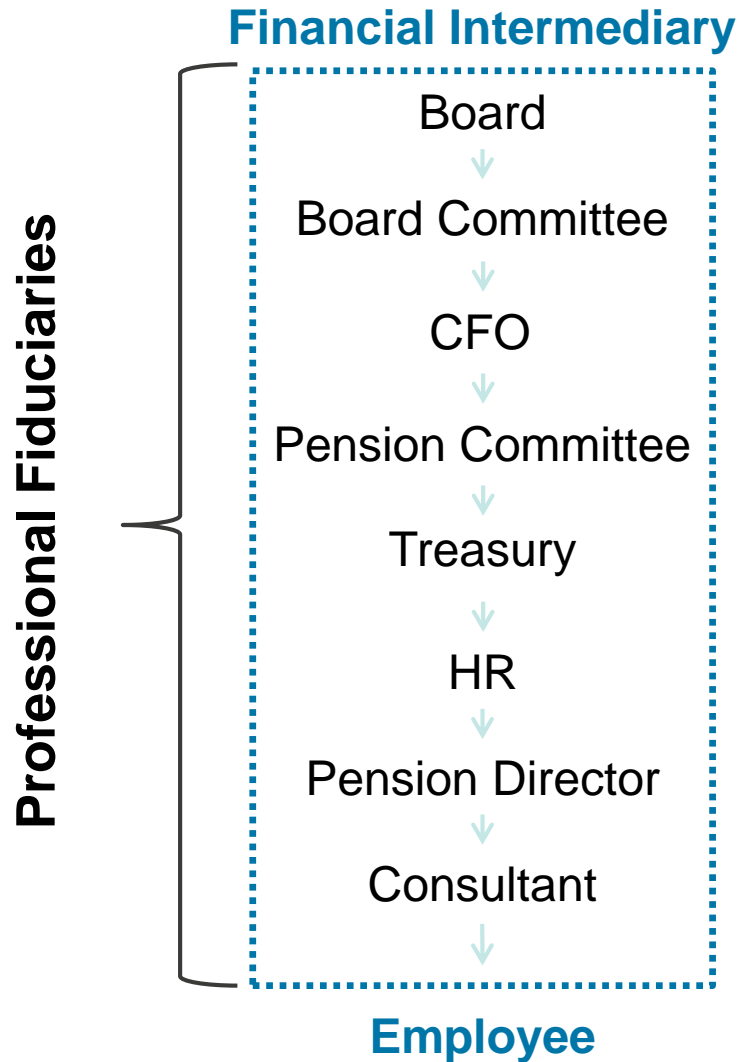
## **2015 CAP Member survey says:**

- “42% of members don’t know what happens to their savings in their Group RRSP when they retire”

## **Risks member has to manage:**

- › Longevity risk
- › Investment risk
- › Inflation risk
- › Cognitive ability

# Governance before and after retirement



# How do Employees Decide?

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- **Retirement income strategy largely driven by *who* provides advice**
- **Behavioural influences:**
  - Choice architecture on option forms
  - Present biased decisions
  - Loss aversion
  - Herding
  - Overconfidence
  - Recent market performance

# Decumulation Support



- Information
- Advice
- Negotiate fees
- Group LIF/ RIF
- VPP
- Group annuity

# Plan sponsor's impact

## For every \$ of retirement income:

- **10¢** is from their contributions to the RRSP
- **30¢** is from their investment earnings during the accumulation phase (pre-retirement)
- **60¢** is from their **post-retirement** investment earnings

	Retail @ 2.20%	Group @ .68%
Now	\$100,000	\$100,000
In 20 years	\$157,584	\$211,651

**\$54,000  
difference!**



# Eckler's CAP Legal Forum

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- Conclusion: no greater risk associated with decumulation than accumulation
- May be more risk in not using your “negotiating power”
- Expectation: additional guidance from regulators



## Thank You

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