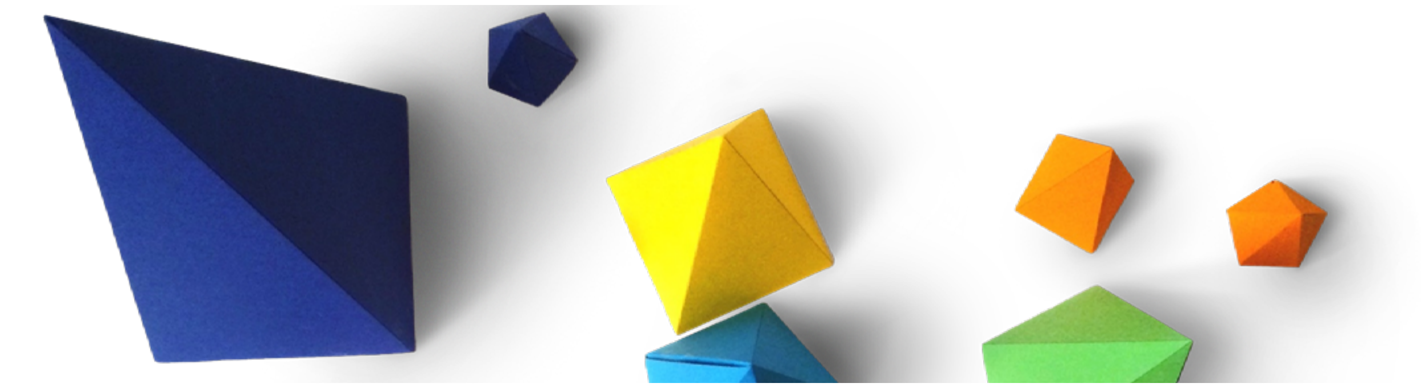
The Evolution of Workplace Retirement and Savings Plan Governance



Evolution of Workplace Retirement and Savings Plan Governance

The Canadian retirement savings landscape is undergoing swift transformations. These evolutions present both challenges and opportunities, influencing how Defined Contribution (DC) plans are governed.

Fiduciaries now face greater responsibilities and urgencies in addressing concerns. This is largely because the Canadian DC market contrasts significantly with other developed markets. In Canada, only about 15% of all retirement assets are within DC plans compared to more than 70% in other developed markets. This suggests that a significant number of Canadian investments are still in defined benefit programs.

Brett Jennings, Principal, National Defined Contribution Advisory Leader at Mercer Canada provides an insightful perspective on the evolution that is taking place in the DC market.

Market dynamics

The DC market is heavily dominated by a few vendors providing investment and administration services; the top three firms possess 86% of the market share. Additionally, the "bundled fee" structure, which amalgamates various costs into one fee, obscures transparency. This has resulted in high costs for participants and is demonstrated in Mercer's 4th Annual Mercer Retirement Readiness Barometer, which showed that millennials renting throughout their lives need to save approximately 50% more than homeowners. The soaring home prices, interest rates, and limited supply are exacerbating these challenges. Baby boomers, on the other hand, saw a 7% reduction in their expected retirement income due to the market decline of 2022.

Current Human Resource challenges*

1. **Employee burnout:** 8 in 10 Canadians faced burnout in 2022, up from 6 in 10 in 2021.
2. **Low savings rate:** Balancing present financial obligations with future savings is becoming increasingly challenging.
3. **Delayed retirement:** The traditional retirement age of 65 is shifting, with many choosing or needing to work longer.
4. **Financial confidence:** Ability to retire is within the top 3 of unmet needs for employees.

**Mercer's Inside Employees' Minds Study, 2022*

Updated Capital Accumulation Plan (CAP) guidelines

As expectations and guidance evolves, plan sponsors should be proactive and develop or update their governance policies. It's been almost two decades since the original CAP guidelines were introduced. The expected updates include:

- **Plan Governance:** Organizations should establish a clear framework detailing how they govern their programs.
- **Decumulation:** The guidelines will now contemplate retirement Income Vehicles to be part of a CAP.
- **Automatic features and member support:** With the rise of automation, the new guidelines will address member communications and resources.

> "The Canadian DC market will continue to evolve as investment options become more sophisticated, and tailored directly to investor needs, focusing on things like creating an income stream or preparing for retirement as examples."
> \- Brett Jennings

Investment evolution

Jennings finds, "The approach to investment and investment risk has changed, and so has the view that plan sponsors have taken over the last 30 years. It started with moving away from defined benefit plans to a DC framework, where the first stab at it was that plan members should have as much choice and access as possible, since they bear all the risk. So, offering a significant number of investment options (think 25), was the order of the day."

The Employee Retirement Income Security Act (ERISA) in the U.S. along with updated perspectives on behavioural finance have since shifted best practice for Canadian Plans. Since 2008 and 2009, target date funds have become increasingly popular drawing significant assets and cash flows.

Today, streamlined investment choices range from 6 to 13 options, with 1 or 2 options available in core asset classes. However, a substantial portion of assets, ranging from 60 to 90%, is being directed towards pre-packaged portfolios such as target date funds.

Jennings opines, "The Canadian DC market will continue to evolve, as investment options become more sophisticated and tailored directly to investor needs, focusing on things like creating an income stream or preparing for retirement as examples."

The traditional focus on the accumulation phase of an investor's journey toward retirement is gradually shifting to encompass decumulation. Updated guidance and regulations will contemplate the evolving needs around the retirement transition and will provide clarity around the types of decision-making tools and information that should be provided to support sound decision making by plan participants.

Today, the decumulation market is currently dominated by group products offered through insurers, often with higher fees than those incurred during the accumulation phase. There are three positions taken by defined contribution plans today:

1. Full transfer out of the plan: This is the most common scenario, where the employer-employee relationship ends upon retirement, and the employee is left to purchase an income product independently.
2. Employer-sponsored retirement vehicles: This emerging trend involves employers providing additional support to employees as they transition into retirement.
3. In-plan retirement options: This is a future-focused approach, with legislation in place to provide a framework for these options.

We expect that the market perspectives will continue to evolve as regulations change and as defined contribution plans continue to grow in size. **BPM**

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