
Damon Williams

Casting safety nets

There will always be those DC plan members who fall into default options and negatively impact their retirement. DC structures need to be altered.

Ever since the migration of Canadian retirement plans from defined benefit designs to defined contribution (DC) designs began, the DC industry has been diligently working at educating plan members on how to make sound investment decisions for their retirement savings. However, the evidence suggests the efforts of DC recordkeepers, investment managers, consultants and plan sponsors have not been wholly successful. The vast majority of participants in Aon Consulting's DC plan sponsor forums felt that education programs were not working to their satisfaction.

This sentiment is reinforced by a recent survey of Canadian DC plans by Sun Life Financial which found that, on average, 44% of DC plan members are 100% invested in their default fund. For a large proportion of these individuals, the default fund is a low-volatility, low-return vehicle such as a money market fund or a GIC. Even among the DC plan members making investment choices, there is evidence that many make inappropriate or illogical choices as a result of lack of understanding.

As an industry, we must face the fact that no matter how much investment information or education we offer, there will always be a large proportion of DC plan members who will never read or understand it. If overwhelmed by the information, they will simply disengage and fall into the default option or make uninformed choices, with a potentially disastrous effect on their future retirement income. We must design DC plan investment structures to address this reality. Assuming the primary purpose of the plan is retirement savings, the following investment structure principles should be considered.

Make the default fund a reasonable vehicle for long-term savings – This would mean a fund with a significant equity component. A balanced fund is reasonable.

A lifecycle fund, in which the member's asset mix evolves as they approach retirement, is better. Money market funds and GICs are sometimes selected as defaults due to sponsor concerns about members losing money from a sponsor-imposed investment decision. However, these vehicles are not appropriate for long-term savings. Even plan members approaching retirement have investment time horizons far longer than those to which money market funds or GICs are suited. With the uncertain evolution of case law in this area, sponsors should also be concerned about this lack of suitability and the extent to which it could damage adequacy of benefits at retirement.

Create a two-pronged investment structure offering both traditional funds and lifecycle funds – Early in any plan enrolment or investment decision-making materials, plan members would be asked a simple question: Would you prefer to learn about investments and build your own customized portfolio, or would you prefer to provide some basic information about yourself and be directed to a portfolio that is reasonable for your circumstances?

Members selecting the first approach would be directed towards a range of traditional investment funds and provided with education materials to aid them with their choice; members selecting the second approach would be directed towards a lifecycle fund or range of asset allocation funds with very little—if any—investment education required. Under this structure, the needs of two diverse groups of plan members can be addressed by providing flexibility on the one hand, simplicity on the other, and an easy way to choose between them.

By not trying to force every DC plan member to learn about investments and by making it easier for members to find their way—either actively or by default—into reasonable portfolios for their long-term retirement savings, we should be able to improve the appropriateness of the average member's portfolio. The result should be fewer plan members reaching retirement age without enough money to retire. **BC**

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