Think Tank

At the **12th Annual DC Plan Summit,** plan sponsors and leading experts gathered to discuss and debate all things DC.

The summit this year, built around the theme Keep it Simple, broke down the complex field of DC into digestible, educational sessions ranging from communicating and targeting messages to members, to structuring the optimal asset mix, to embracing advice.

The summit kicked off with a keynote presentation by Amber MacArthur, a social media consultant, journalist and author. MacArthur spoke about just how much the exploding field of social media has permeated our lives and how plan sponsors can use it to educate and interact with their members.

The following six pages offer highlights of each presentation. For more ways DC plan sponsors can keep it simple, tune into our video at benefitscanada.com/pensions/cap under "Simply put at the DC Plan Summit." **BC**

Anna Pagliuca *is associate vice-president, customer experience, group savings and retirement, with the Standard Life Assurance Company of Canada.*

Targeted Messaging: Narrowcasting to the Member

Getting the message out is rarely the problem. With email, printed communications and the exploding realm of social media, it's easy to broadcast messages to members. But getting members to listen, take action and understand the "what" and "why" of the communication can often be a challenge.

One reason is that when a message is broadcast, it doesn't speak directly to a member's particular situation. We all like to receive information that is uniquely tailored to our needs.

Targeting a message to a member's unique situation that offers actionable solutions is an effective way to communicate. A 2010 Standard Life survey uncovered some interesting facts on how Canadian plan members react to their statements. For instance, while almost every plan member receives a statement, fewer than half actually review the statement thoroughly. To put that in perspective, 49% skim it; 5% don't even bother to read it.

Some of the reasons they don't engage with their statements? Members find them boring (24%) and too technical (36%), some members are not thinking about retirement (21%), and some find the statements depressing (12%).

Therefore, when looking at effective statement design, plan sponsors need to address the concerns of members and ensure that these communications are simple, engaging, insightful and actionable. To make a long story short, they need to be less boring! A good starting point is length. With the almost universal access to secure online account information, the statement should be on point and simple to understand. A detailed transaction listing (which takes up many pages) doesn't necessarily add to the readability of a statement, so why include it?

For instance, with many of the new portfolio investment options, the members' investor profiles are recorded. If they deviate from this investment style, a targeted message should inform them of this fact and guide them toward adjusting their circumstances.

Focusing members' attention on their retirement goals is another effective way of targeting a message to them. Placing a graphic illustration of their current situation vis-à-vis their ultimate income goal on the statement will likely get their attention. By using a set of assumptions as a starting point, members don't necessarily need to make the first step in order to activate their objective. With a simple presentation method they can see at a glance how they are progressing toward that goal. And, more importantly, if there is an income gap, simple suggestions and guidance can be provided to get them on track.

Plan sponsors can do a lot to help members understand and engage with their retirement plan. Simplifying the presentation of information by making their statements concise and a little less boring is a start. **BC**

Nadia Darwish *is vice-president, client relationships and business development, group retirement services, with Sun Life Financial.*

Action in the Moment

Procrastination, confusion and a harried lifestyle are all causes of plan member inertia. DC pension plan providers continue to look for ways to break through inertia and help members reach long-term financial security. We're not asking them to go to financial boot camp. We're asking them to fill out a form, join a plan, contribute, maximize matching contributions, pick investments that reflect their goals and resist taking money out of these investments before they reach retirement. So what's the right ingredient?

Throwing more information at members through education and communication works to some degree but doesn't necessarily motivate them. What's needed is something economist Richard Thaler calls a *nudge.* The nudge theory encourages people to make good decisions without imposing restrictions, while leaving all of the poorer choices open. It works two ways: create incentives or remove barriers to achieve a desired action.

DC plan sponsors and their providers can use various strategies to nudge members to act and prolong plan engagement.

There are differing opinions on advice, but we can all agree it helps members take action—especially when they can't decide which plan, investment or contribution level is right for them. Why not leverage the call centre or on-site education specialists offered through providers to support members in the decision-making? These are critical moments when members are on the cusp of taking action; a nudge makes it a truly simple task.

Most employees have the best of intentions when they participate in an enrollment workshop, but when they leave—forms or online enrollment instructions in hand—they often fail to follow up and act. It's the same old story—life gets busy, retirement is decades away and the motivation to enrol fades.

Hand out a wireless tablet at these sessions and suddenly employees enrol instantly. According to Mass Mutual in the U.S., wireless enrollment sign-up rates are as high as 90% compared with traditional sign-up rates closer to 50%.

Technology can simplify the interactions with members and enable them to act. Smart-phone applications or mobile-optimized websites can increase accessibility of tools, balances and transactions for the growing number of Canadians who own smart phones. Introducing new media channels such as interactive avatars and social media marketing helps capture the attention of the growing younger workforce.

The default option can be redesigned so that employees are automatically enrolled into their workplace plan at a pre-set contribution rate. A recent analysis by Fidelity Investments in the U.S., where auto-enrollment is permitted, found that only one in 10 employees proactively opt out of the plan.

What's the best way to reduce member inertia? Nudge them. Remove barriers and create incentives without taking away their choices. While most of the boomer bulge is still pre-retirement, the leading edge has passed age 60 and is now in the "need to start saving" years. If there was ever a time for a nudge, it's now. **BC**

Shawn Cohen *is a senior investment consultant with Aon Hewitt.*

Aligning Investment Structures with DC Plan Design, Member Knowledge and Engagement

Plan sponsors often determine their DC plan's investment structure around what the industry is offering, rather than what is best suited to their own plan objectives and members. It's time for sponsors to step back and consider the structure that makes the most sense in their particular circumstances—and for the industry to respond accordingly.

For the most part, even with plan sponsors' efforts to reduce plan member confusion around investment decision-making (including offering target risk and target date funds), DC plan member knowledge and engagement remain low.

In order to better align investment structure with plan design and member knowledge and engagement, plan sponsors first need to revisit the purpose of the plan. Is it the primary retirement vehicle that the employer is offering, or does it provide supplementary retirement income? For instance, is there also a DB plan, or are additional capital accumulation plans available?

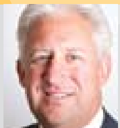
Each plan sponsor will inherently approach the development of an investment structure from a different perspective. The plan sponsor may want to "protect members from themselves," encourage plan members to be self-sufficient or take a position somewhere between the two. Determining where the plan sponsor lies on this spectrum will help decide the amount of flexibility to include in the investment structure.

There are other plan sponsor considerations that will naturally come into play: an understanding of what competitors are doing, along with an appreciation of any additional due diligence or costs that might arise on a change of investment structure.

While plan sponsor considerations are significant, it is equally or more important to determine the level of plan members' knowledge and engagement, assessed through surveys and utilization analysis. The plan sponsor may discover that various segments of its plan membership are more knowledgeable and engaged than others and be able to segment the population, offering each group a different lineup of investment options that cater to its particular circumstances.

Plan sponsors are currently able to move from an aggregate investment structure to a segmented approach at the group level. (Providers can accommodate such requests.) Ideally, in the near future, recordkeepers will develop the capability to offer investment structures at the member level so that two employees sitting side by side at the same company will have individualized DC plan options that suit their specific knowledge and engagement levels, with plan communication and education geared accordingly.

Given today's diverse employee populations, a one-for-all approach to DC plan investments will not meet the needs of plan members. By placing the focus on the plan's goals and members' individual requirements, plan sponsors can develop more effective investment structures. **BC**



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The Paradox of Investment Performance: Well Understood, Poorly Understood

Investors generally understand the interpretation of annualized investment performance. However, when it comes to making investment decisions, investors tend to place undue importance on recent investment performance.

As a group, investors consistently believe there is information in recent past investment performance that will help them select future outperforming strategies. But emerging research suggests that this is a dangerous strategy and that performance reversion is a common outcome. The 2010 *Quantitative Analysis of Investor Behavior* observes that the average U.S. equity investor earned 20-year annualized returns of roughly 3% versus the equity markets at near 8%. The performance gap is attributable to a short average holding period of just over three years for an equity mutual fund. Simply put, investors buy funds with strong recent performance and sell following recent underperformance with the result being an investment experience well below the market.

The Selection and Termination of Investment Management Firms by Plan Sponsors study looked at institutional markets by examining both pre- and post-manager change investment performance of more than 8,700 changes made by institutional investors. Conclusions indicated that based on three-year trailing and forward performance status quo, making no change would have outperformed changing managers.

Another study—*Absence of Value: An Analysis of Investment Decisions by Institutional Plan Sponsors*—analyzed pooled funds by comparing funds that have experienced strong contributions to those in withdrawal. Subsequent performance mean reverted with outflow funds outperforming strong sellers in the next one-, three- and five-year periods. Within the Canadian marketplace, a ranking of Canadian pooled funds' performance for a four-year period ending 2006 in order can be compared with the performance of the next four years. The outcome indicates a random subsequent period performance with just two of the top 10 performers delivering above-average performance and five of the bottom 10 outperforming the average.

These studies suggest that the odds of successful switching based on recent performance are stacked against success and that the costs of this are largely unconsidered. Successful investing should continue to recognize that market cycles are much longer than typical four- or five-year periods. Engaging investment management firms with established succession planning, a strong compliance culture and a well-defined process can help minimize the need for changes. Also, building an understanding of performance relative to the market and investment style can help rationalize short-term performance. Regular meetings with managers can help investors understand the strategy and remain vigilant to a strategy capitulation whereby managers may erode value by chasing a theme in the market. **BC**

Brett Marchand *is vice-president, sales, group retirement solutions, with Manulife Financial.*

Financial Literacy and Saving for Retirement: The Link That Never Was

The need to boost financial literacy among Canadians continues to capture a growing measure of attention from government and the media, plus plan sponsors, providers and consultants in the retirement industry. Canadians clearly have ground to cover if they're going to improve their understanding of, and the control they exert over, their finances.

Since 1990, the ratio of debt to household income has ballooned from just below 90% to well over 140%, according to Statistics Canada, fuelled in large part by a consumer population that finances its "wants" with credit. The figure is cause for concern, but in tandem with the low levels of savings Canadians amass (one of the lowest among the Organisation for Economic Co-operation and Development nations in a 2007 review), the picture grows more challenging—particularly in terms of helping those in their 40s and 50s prepare for retirement. If (or maybe when) rates rise, debt will be a hurdle in the way of retirement. In *Benefits Canada*'s 2010 *CAP Member Survey*, two-thirds of respondents already express concern about building sufficient savings for retirement.

Short- and long-term strategies are needed. The short-term effort must help the pre-retirement cohort, while a concurrent long-term initiative works to improve overall financial literacy, preventing future generations from facing the same predicament.

Auto options represent the shortest—and most effective—strategy for getting Canadians on a path to an improved retirement. Auto-enrollment, auto-escalation and a selection of suitable investment options can ensure that most Canadians don't forfeit the opportunity to act in their own best interests. The federal government's effort to expand access to group retirement options to include smaller employers and the self-employed will boost the proportion of the population that can be served by these options.

Delivering advice broadly is equally vital as it improves understanding and assurance. A recent Ipsos Reid survey confirmed that Canadians who work with an advisor are 33% more likely to express confidence about having enough to retire comfortably.

Longer term, a sustained educational effort—beginning in elementary and secondary schools, then continuing to workplace programs—will be necessary to help Canadians understand how to plan, budget and live within their means. As was the case with initiatives to introduce mandatory seat belt use and helmets for cyclists, programs will require the co-operation and commitment of participants from governments and industry.

Plan sponsors, their advisors and providers already have expertise working with employee populations that will be valuable in the effort to improve the choices of future generations. When the demand for financial planning advice parallels the frenzy for new consumer trends, we'll know we've put the next generations on a better footing than their predecessors. **BC**

Idan Shlesinger *is managing partner, capital accumulation plan services, with Morneau Shepell.*

A Fresh Look at Holistic and Integrated Retirement Planning Tools

The grasshopper spent the warm months singing away while the ant worked to store up food for winter. When winter arrived, the grasshopper was dying of hunger, and, upon asking the ant for food, was only rebuked for its idleness.

This fable is used to teach the importance of saving, but it misses the point. Did the ant save enough or too much? Did the grasshopper enjoy the summer and still manage to subsist in winter by scrimping and relying on social support? Capital accumulation plan (CAP) members face this very dilemma, since CAPs focus more on saving and investing than on retirement income. A retirement income planning tool, then, can help to overcome this challenge by translating accumulation into future income.

The first step is to determine the income target. Conventional wisdom calls for replacing 70% to 80% of income in retirement. Recent analysis demonstrates, however, that for many, the neutral retirement income target may, in fact, be substantially lower after the retiree adjusts for expenses that diminish or disappear in retirement. These expenses typically include mortgage costs, childcare, taxes, retirement savings and employment costs.

Once the income target is established, most tools have the same basic functionality. However, progressive plan sponsors should consider whether a few less common but very powerful features should be present in the tool offered to their employees

Comprehensiveness: To ensure that maximum value is derived from a planning tool, the tool must be comprehensive, reflecting DB and DC programs, including closed plans, as well as entitlements from previous employers and other savings arrangements.

Expert Opinion: A critical assumption in any projection is the rate of return. Many tools will ask the user to input this key variable, though we know that very few non-experts can provide a realistic assumption. The best tools use expert insight and the actual investments chosen to determine a realistic rate of return, without ever asking the question.

Transparency: Presenting a single projection will mislead users into believing that results are known and that specific action will guarantee success or failure when, in fact, we know that results are extremely uncertain. The best tools simultaneously display a range of scenarios. This approach educates the user and assists with investment decisions that may impact pessimistic and optimistic scenarios differently. More importantly, this approach won't mislead your employees and put you at unnecessary risk.

New and improved tools are in development. In the future, expect enhanced use of technology, both from an accessibility standpoint and in the form of integrated tools. Ultimately, employers must consider what they'd like their tools to achieve and how they should be used. However, tools should always be engaging and should spur employees to take action. **BC**

Serge Pépin *is head of investments with BMO Investments Inc.*

2011, Another Year in Transition

Plan members, as investors, appear to remain skittish and nervous about the stock market despite the relatively strong rebound in stock prices over the past two years. Notwithstanding a bump or two along the way, Canada's TSX has regained all but about 10% of the losses it incurred in the six months following the bursting of the housing bubble in 2008 that jump-started the worst financial crisis since the Great Depression of the 1930s. Then again, who can blame investors for being reluctant to jump back in with both feet? Market participants—from the novice to the most sophisticated—have suffered two major setbacks in stock market activity since the turn of the new millennium: the tech wreck of 2000 and the world's first major co-ordinated economic downturn eight years later.

There are a number of economic and financial factors that can be characterized as encouraging, mixed and scary at best. First, the economic recovery will only get stronger. Conditions such as the low interest rate and inflationary environment in the developed world will continue to support economic growth. In addition, stock markets will remain attractive from a value point of view. Corporate earnings have recovered and remain strong.

There are, however, a number of factors that could limit overall gains. The state of the fiscal health of many European countries—Portugal, Ireland, Italy, Greece and Spain, to name a few—is of major concern. The lack of employment growth in the United States is also of concern, and the potential of a slowdown in the emerging markets' economic engines is not to be dismissed. The developed world's economy can no longer depend solely on the American consumer to rescue it from the bottom. The spectacular growth of the developing world's middle class and its strong consumption appetite—China's in particular—have been major contributors to the North American economic rebound and are expected to continue to be so for the foreseeable future. Adopting tighter monetary policies as witnessed in China as a way of controlling economic growth to stem overheating and inflationary pressures will likely continue to dictate investor behaviour in our own market.

As plan members face daunting questions every day, it is increasingly important for plan sponsors to deal with a recordkeeper that will provide them with the proper tools and mechanisms to assist them in meeting their obligations. While plan sponsors must choose sound investments, they should also seek out essential education and tools such as investor profile questionnaires and investment selection tools.

Such tools help plan members steer the course during volatile times and keep true to their own risk profile and retirement goals. These are tools not generally available to most investors; hence, their use may be a factor in member behaviour generally being more conservative in volatile times than experienced in the marketplace as a whole. **BC**

Peter Drake *is vice-president, retirement and economic research, with Pyramis Global Advisors.*

Decumulation: Readying Canadians for Retirement

Canadians face a number of concerns as they near retirement. Investors who are about to start decumulating are seeking sound advice to help them replace uncertainty with informed judgment. They worry about whether they have saved enough, how markets will behave and if their approach to investing should be more conservative in view of market volatility in recent years. They wonder, too, about withdrawal rates in retirement and how they will maintain their lifestyles.

According to Statistics Canada, the third of Canadians who are approaching retirement will rely on multiple sources of income in retirement—a mix of public and private pensions, as well as investments and earned income they generate themselves. At the same time, this generation is redefining retirement, with many choosing either to transition gradually from work or to continue working indefinitely—some out of necessity, others by choice.

If they wish to maintain their lifestyles in retirement, Canadians will have to figure out how to replace enough of their pre-retirement income to manage it. They'll also have to consider the five key risks to retirement income and the kinds of personal savings vehicles they'll require to address those risks.

The first risk is *longevity:* people may live longer than they might expect. According to the Canadian Institute of Actuaries UP-94 projected to 2015, a woman age 65 has a 50% chance of living to 86 and a 25% chance of living until 92. Her savings may have to last many years.

During that time, the second risk will be *inflation,* and even a low rate could have serious consequences. A 2% annual inflation rate will reduce an individual's purchasing power over 25 years by roughly 40%.

The third risk has to do with *asset allocation.* What asset mix will generate sufficient returns, ensure that a retirement portfolio lasts as long as needed and allow the investor peace of mind? The starting point for most is a well-balanced portfolio.

Related to this is the *annual withdrawal rate,* the fourth risk. In the wake of the market volatility, many retirees felt added pressure to increase their withdrawal rates. But the truth remains that lower withdrawal rates make portfolios last considerably longer. An enduring portfolio is even more desirable considering the fifth risk to retirement income, *unforeseen out-of-pocket healthcare costs.*

To manage these five risks effectively, individuals must understand how different investments and income sources—be they pensions, government programs, annuities, mutual funds, fixed income securities or cash—come with different strengths and weaknesses. They also need to replace uncertainty with certainty by taking basic steps to create a retirement income plan. By planning to fund essential expenses with sure and stable sources of income, individuals can ready themselves for retirement more effectively. **BC**

Thomas Nelson *is director of quantitative research with Franklin Templeton Institutional.*

Optimal Asset Mix: Does One Size Fit All?

Risk is a central concept in investing, particularly for retirement solutions in DC pension plans. However, the analysis of risk is potentially complicated, as the tolerance levels of individual plan members can vary considerably.

Most, if not all, individual plan members share the basic factors influencing risk tolerance. Virtually all members want to accumulate a solid nest egg that will last through retirement and beyond their lifetime. Furthermore, almost all plan members are looking for a solution that will generate a level of income adequate for their desired lifestyle.

However, several variables come into play that can result in different levels of risk tolerance. Portfolio size is one: a larger pool of assets may require more protection and result in a lower risk appetite. Moreover, a plan member's time horizon is often a main determining factor. A member in her 20s, for example, will likely have a much longer time period between now and retirement, as opposed to members in their peak-earning 40s or near-retirement 50s and 60s. Matching the right asset mix to a plan member's time horizon and resultant risk tolerance level is essential.

There are additional factors impacting risk tolerance that can't be as easily calculated. Sometimes the factors are psychological: a survey of investors indicates that most are generally bullish on equities but comparatively few are actually investing.

Another dimension in risk tolerance is preference and attitude. Two investors could be the same age but have radically different views on risk.

Plan sponsors can access many different investment solutions to account for such wide ranges of risk tolerance levels among members. Two of the most common types are balanced funds and target date funds (TDFs). Each may have the same goal in mind, but the journey there can be substantially different. For example, according to a Franklin Templeton Investments simulation, over a 40-year period, a group of balanced funds can generate wider variations in performance compared to their target date counterparts and can carry a notably higher risk level in the critical decade before retirement.

The principal way TDFs manage risk is through an asset allocation glide path, which changes in lockstep with an investor's march toward retirement. The target date approach can be further refined by providing target risk options—for aggressive, moderate or conservative investors, for example—that can help create a retirement glide path with the optimal combination of portfolio longevity and risk management.

With a significant proportion of plan members in their 40s and 50s, the target date/target risk glide path is a timely solution to address the risk tolerance and risk preference levels of this important segment. **BC**

Michael Campbell *is vice-president, market development, wealth management, with Great-West Life.*

Embracing Advice

These days, capital accumulation plan (CAP) sponsors have a big job. Many plan members look to them for advice on their retirement plans. But sponsors don't want to be accountable for providing it. So how do they deliver on the need for advice, given the risks associated with offering it?

Education and information will always be important and helpful to members, but most want someone to tell them what to do. They want personal investment advice—and with good reason. A 2010 U.S. report sponsored by Hewitt Associates and Financial Engines of more than 400,000 plan members indicates that investment returns improve by almost 2% with advice, significantly adding to a member's retirement savings.

According to the *CAP Guidelines,* the onus is on the plan sponsor to regularly review the quality of advice offered by its service provider. Because of the risk associated with this responsibility, many plan sponsors are hesitant to offer members that kind of service. And the larger the company, the less likely it is to offer advice because it's a challenge to provide consistent advice across the company. Advice should be offered only to members who are engaged in their retirement plan. It cannot work as a magic bullet for unengaged members. Plan sponsors still need to offer an effective default investment fund.

Offering advice isn't without risks, though. But there are ways to help protect plan sponsors and members.

Before offering members advice, plan sponsors should assess their company's needs. Knowing the organization will help sponsors decide whether to offer advice and to whom, and how best to communicate with members.

Mass Advice: If the plan sponsor's company has many sites across the country, providing telephone-supported advice may be a great option. Sponsors can ensure advice is consistent because members—whether in Whitehorse or Halifax—are calling one location that has a single, repeatable process.

Targeted Advice: Usually delivered face to face, targeted advice generally involves much broader financial guidance. Advisors can make recommendations by taking into consideration members' personal circumstances and their savings outside of the group plan. Plan sponsors can reduce costs by offering the service to certain groups, such as individuals getting close to retirement or executives.

Sponsors should choose a provider that's accountable for the quality of advice it provides. Ask the provider to demonstrate how it takes members through the advice-giving process. Is the process repeatable? How is the service monitored?

Finally, plan sponsors should monitor the provider's performance to help them make adjustments to the strategy.

Plan sponsors select their employees carefully to make sure they're the right fit for the organization; they should do the same with advice providers. By doing their homework, plan sponsors can deliver on the need for advice while minimizing the risks associated with providing it. **BC**

Michael Cooke *is vice-president, global investment strategies, with Invesco.*

What Should Balanced Funds Balance?

The economic downturn of 2008 exposed the risk in asset allocation products designed in and built for a "Goldilocks" environment of non-inflationary growth. With a changing environment, it is time to revisit the assumptions and models used in the past to construct DC asset allocation products.

Most DC plan options employ the traditional 60/40 asset allocation model, but 90% of the risk comes from stocks. As a result, traditional balanced products often perform well in periods of non-inflationary growth but perform poorly in periods that don't favour stocks—namely, recession and inflationary growth periods. In other words, the risk in this traditional product is not balanced among the different economic environments, which affect asset class returns very differently.

Instead of balancing an asset mix based on targeted returns, the balancing of risk, or risk parity, should be the guiding principle behind asset allocation. In a risk-balanced product, an equal amount of risk comes from assets representing each economic environment: recession, non-inflationary growth and inflationary growth. This process is designed to provide plan members with respectable investment returns by avoiding significant drawdowns along the way. It is an investment process worthy of consideration as the global economy recovers from a balance sheet recession and is confronted by an uncertain range of economic outcomes.

For DC plan options, target risk portfolios that offer a range of risk tolerance levels can satisfy the needs of plan members in a single, simple-to-use solution if they employ a strategic asset allocation model that balances risk by combining asset classes that should benefit from different economic environments. These portfolios should also provide tactical asset allocation to capitalize on near-term market opportunities or to mitigate risk; a strategic blend of active- and index-based solutions to further improve diversification; and currency risk management to reduce the risk of holding foreign securities in a portfolio. Target date portfolios should build a foundation based on the strategic asset allocation process just described while also offering plan members a range of investment horizons that seek to preserve capital and reduce risk.

Structuring target risk and target date portfolios this way gives plan sponsors and members more of what they expect from asset allocation solutions (multiple investments, automatic rebalancing, currency hedging, simplified reporting), combined with the innovation of the balanced risk process and its unique asset allocation process.

A changing environment requires evolution of the asset allocation models used in many DC plans today. Target risk and target date portfolios should use a balanced risk approach to asset allocation to navigate member portfolios through an uncertain investment environment and to provide better risk management. **BC**