Key Findings and Action Items

Defined Contribution (DC) Program
Vancouver, Canada

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High-Level Overview of Issues for DC Systems

Keith Ambachtsheer (KPA Advisory/ICPM) and **Neil Lloyd** (Mercer) convened an introductory panel system to overview DC landscape globally, identify the major issues and opportunities facing DC, and provide some challenging perspectives on traditional views of DC. **Ida Rademacher** (Aspen FSP) moderated the discussion.

Key Takeaways:

We need to integrate both macro and micro perspectives to get the whole story. From a micro perspective, people need a lot of help identifying their 'optimal' life-cycle strategies. However, the help offered must not take advantage of the asymmetric information problem. This 'help provision' question requires a macro-level perspective.

From a macro perspective, we need to think of the respective roles of governments, employers, and individuals in creating an effective multi-pillar Retirement Income System (RIS).

Retirement Income System

Pillar #1: Government	Pillar #2: Workplace	Pillar #3: Individual
• A base universal pension provided by government on a pay-go basis. • Key Challenges: size, sustainability, and integration with pillars #2 and #3.	• A pre-funded employment-based pension provided through the employer. • Key Challenges: Mandatory vs. Voluntary participation, distribution strategies and pension organization design.	• An individual retirement savings program provided through the financial services industry. • Key Challenges: Enforcing fiduciary duty to manage the asymmetric information issue, and the problems of behavioural bias and longevity risk.

Figure 1: 3-Pillar RIS system.

The Melbourne Mercer Global Pension Index ranks the retirement systems around the world, covering 30 countries and 60% of the population. To do this, it uses three key sub-indices: adequacy, sustainability and integrity.

The survey highlights the need to enhance trust in the private pension system. To achieve this, we must strike a balance between adequacy and sustainability, increase heterogeneity with tailored solutions, expand workforce coverage to offer access to the self-employed, and account for increasing longevity and changing workforce patterns.

There will be winners and losers if DC plans decide to pool participants. Therefore, it is important to adapt to the changing workforce, reduce gender imbalance, share risk to lessen burdens and be conscious of financial needs. Today's workforce is not only concerned about being able to retire, but they also want to have enough financial freedom to enjoy retired life.

Hot Topics:

The three Pillars may require revisions, as they are very path dependent and errors may have been made during their creation. Due to the high risk and expense for most employers, the popularity of pure DB plans is waning, and new, sustainable versions are beginning to emerge, e.g.. risk-sharing, agreed-on traffic light action list, collective DC. When designing a new system, it will be necessary to reconsider what the risks are and for whom we are solving them, as well as who will deliver the new system. Regardless of the answers, focus should be on design and delivery rather than profitability. Other dimensions we may one day be able to solve for one day include, innovation, regulatory guidance, longevity, and integrated reporting.

People want to stay in the workforce for longer, but AI has changed the very nature of work, directly affecting the kinds and availability of jobs. This causes one to wonder about the type of work that will be available to those who choose to delay retirement.

Specifically, in regards to the second Pillar, we must determine how to deliver this particular system in a cost-effective and collective way that takes into consideration our dynamic, fluid environment. This will either require new institutions, or our existing ones to respond accordingly to these signals. We may also need new tools and solutions. It is therefore important to learn and understand together what the best practices are now and into the future.

Actions:

- Addressing the challenges of Pillar #3 together will require transitioning people from Pillar #3 to a well-designed Pillar #2
- Private pension systems need to be expanded so they can include the entire workforce
- Improve governance of private and public pension systems
- The focus in DC should be on individual needs

Further Reading:

- Beyond DB and DC: Towards Retirement Income Plans for the 21st Century – Keith Ambachtsheer, July 2019.
- World Bank Contribution in 1994: "Averting The Old Age Crisis"

System Design Challenges: Reaching New Groups of Savers

Katie Selenski (CalSavers) and **Courtney Eccles** (Secure Choice Illinois) shared the state-level efforts in the US to reach new groups of savers. They discuss the gap these States are trying to bridge, the design of their programs, and lessons learned. **Lew Minsky** (Defined Contribution Institutional Investment Association (DCIIA)) moderated the discussion.

Key Takeaways:

Plan sponsors should adopt institutional strategies in their DC plans to produce better retirement outcomes for participants. Data shows significant asymmetry in plan fees by asset segment, highlighting the importance of scale.

California and Illinois have created policies to address the coverage gap by requiring some employers to facilitate a state-sponsored program in which employees would be automatically enrolled, while still allowing workers to opt out. Research indicates workers with a payroll deduction savings option are 15 times more likely to be on a path to retirement security and 20 times more likely when it's automatic enrolment (AARP). Payroll industry integration, participant retention and engagement, retirement income phase options and scale are some of the key challenges and opportunities along the way.

Public-private partnerships, e.g. Illinois Secure Choice and CalSavers, combine government policy, which pushes the mandate, and private sector services to provide the solution. While these initiatives do create a new cohort of savers, there are certain challenges associated with their implementation, e.g. the marketing and outreach on a shoestring, length of time it takes to get employers across the finish line, the structure/timing of wave rollouts and payroll integration.

Hot Topics:

The interaction between payroll providers, employers, and the state programs is an area ripe for further development and efficiency. Automated processes will make participation easier for payroll providers and employers. However, many employers are not using payroll providers and there are still some payroll providers which are not automated. In small businesses, the apparent lack of loyalty to payroll providers may provide a business opportunity for those who integrate technology with the state-sponsored programs simply and cheaply.

Although certain programs do not include employer or government contributions, it is still possible to have high rates of participation. To achieve this, it is important to position them properly, i.e. reminding participants that while they are a good way for them to start saving, they likely will not be the only source of retirement income they need.

Actions:

- We need a more complete approach. These programs are filling a gap but there are still more to be filled.
- Given the changing workforce , pension plans must do more to include everyone so everyone is able to save for the future, including small employers, contractors, self-employed, and those on any form of income support, e.g. parental leave.

Further Reading:

- DCIIA. 13 October 2011. Institutionalizing DC Plans: Reasons Why and Methods How.

Innovation in DC: Investment Design

Mark Fawcett (NEST) and **Brnic van Wyk** (QSuper) discussed emerging innovations in the design of DC investment strategies

Key Takeaways:

QSuper removed peer relative objectives from its investment scorecard to build a better Balanced option focused primarily on an absolute return objective. This was as a result of noting a significant difference in outcomes of identical people retiring at different times, e.g. 18 months apart. Therefore, what really matters is the member outcomes.

QSuper's philosophy is a risk-balanced approach that aims to diversify across and within asset classes. This was initially achieved through reduced exposure to equities, meaningful allocation to high-duration fixed interest and investing aggressively in unlisted investments like private equity, infrastructure and real restate.

Its Board exercises the fiduciary duty to invest on behalf of members who don't select an investment option. There are differentiated strategies for separate groups of default DC members (based on age and accumulated savings) by applying basic ALM methodologies.

In deciding where to focus resources and fee budgets, QSuper acknowledges that in listed equity and fixed income markets, dispersion in returns across the manager universe is much smaller than in unlisted markets, e.g. private equity, infrastructure and direct real estate. Alpha may exist in public markets, but it is hard to identify reliably on an ex-ante basis.

Hot Topics:

QSuper focuses on participants' retirement outcomes and managing risks relative to this objective. This contrasts with most DC funds that focus on maximizing rolling time-weighted returns. QSuper started by changing the way it sets investment strategy for the accumulation phase. Investment strategy is one lever available to the Board, but much work is also done around engagement, advice and insurance. Going forward, the retirement drawdown phase will be a priority.

Although DC plans are reluctant to add illiquid assets like infrastructure, QSuper feels the benefits outweigh the challenges. As a result, it has direct investment in real estate and infrastructure. Illiquid assets provide higher net returns to compensate for illiquidity and, while the fee structure may be different, these assets reduce portfolio volatility through diversification from public markets.

Regarding security selection, QSuper insources the composition of a listed equity portfolio and outsources execution. The overall portfolio is risk balanced, so it uses liquidity pockets to complete balancing. While its listed equity index is published to the manager, the rest of the portfolio is not observable to managers. High duration bonds and cash are managed internally. The main goal is to fulfil the promise of delivering the long-term portfolio objective return and the QSuper team has been able to achieve this consistently with almost half the risk (volatility) of industry peers.

Actions:

- As retirees seek more control and flexibility over their financial affairs, we must develop sustainable and robust income products.

Keynote Address - Beyond the Lamp Post: Automatic Enrolment's Impact Outside the Savings Plan

James Choi (Yale School of Management)

Key Takeaways:

Automatically enrolling employees into DC retirement savings plans has become a commonly used method to increase economic security in retirement. Current research shows that automatic enrolment (AE) increases both the fraction of employees who contribute to the savings plan and the average contribution rate (if the default contribution rate is not too low).

Outside of the savings plan, the following impacts of AE have also been identified:

- Debt: Can't reject hypothesis that AE has no effect on debt and creditworthiness
- Saving in next pension: No crowd-out if next pension also uses AE
- Pre-retirement withdrawals: Some erosion occurs, but not 100%. Thus, the benefits of AE are not completely lost by pre-retirement withdrawals

Hot Topics:

Different pre-retirement withdrawal rates may occur across companies due to the size of account balances at job separation, which is affected by salary, the default contribution rate, and employee turnover rates. Employees with larger balances at separation are less likely to take a pre-retirement withdrawal.

Actions:

- Well-meaning policies can have unintended negative side effects. These unintended consequences must be taken into account when debating whether a policy produces a net benefit or not.
- Larger samples and a more complete balance sheet perspective will be necessary before we fully understand the impact of automatic enrolment.
- The impact of AE on non-retirement savings/assets still needs to be uncovered

Further Reading:

- Beshears et al., 2019, "Borrowing to Save? The Impact of Automatic Enrolment on Debt"
- Beshears et al., 2019, "Potential vs. realized savings under automatic enrolment"
- Choukhmane, 2019, "Default options and retirement saving dynamics"
- Jonathan Cribb and Carl Emmerson, 2019. "Requiring auto-enrollment: Lessons from UK retirement plans." Center for Retirement Research.

Innovation in DC: Retirement Income Design

Christine Stokes (TIAA/Nuveen) explored retirement income readiness and the challenges with converting DC assets to income in retirement. **Anne Lester** (J.P. Morgan Asset Management) addressed the Retirement Income Landscape and Solution Design. **Barbara Sanders** (Simon Fraser University) moderated the discussion.

Anne Lester

Key Takeaways:

After analyzing retiree spending behaviour using proprietary, anonymized Chase data of nearly 5.8 million households, researchers found three surprises. First, real spending peaks when people are in their 50s and declines after that. So assuming static spending and inflation throughout retirement, which many models do today, may lead to overstating actual spending needs by as much as 26% by age 95 for the median household.

Second, despite that long-term trend, people don't always reduce spending immediately once they retire and spend more than anticipated as they prepare for a new life stage. This creates a surge in spending in early retirement years and can damage portfolio value.

Third, spending volatility can remain prevalent throughout retirement, so post-retirement investment solutions must provide spending flexibility while also managing risk.

Christine Stokes

Key Takeaways:

The U.S. retirement system has three major gaps: coverage, savings and guarantees.

Key retirement risks include longevity, inflation, market, interest and cognitive Impairment. Employees need to plan for these retirement risks along with a source of dependable income.

Plan design and the investment solutions should evolve to meet the needs of plan participants. Inclusion of a guaranteed lifetime income option may also help decrease annual workforce costs. Research suggests a one-year delay in retirement age may increase annual cost to employers by up to 1.5%.

Hot Topics:

While default fund strategies take the complexity away from participants, retirement needs and risk appetites vary by individual. Fortunately, the pension industry is willing to innovate and increase personalization; however, broader coalition and more alignment within the industry is recommended. Default options should have a holistic approach and allow for more than just lump-sum distributions.

Actions:

- The spending curve is different for each generation, so we must be better optimizers solving for consumption and protection.
- Begin to understand and evaluate how plan design and default solutions can evolve to include investment options that provide the option for guaranteed retirement income for life.
- There must be more education on how to transform savings into lifetime income.

Changing Saver Behaviour: What Works?

Lisa Bruggen (Maastricht University), **Nico Lacatera** (Rotman School of Management) and **Rob Bauer** (ICPM/Maastricht) focused on different approaches to helping individuals improve their choices within DC plans. **Alwin Oerlemans** (APG) moderated the discussion.

Key Takeaways:

Lisa Bruggen

Various concepts in behavioural economics can be employed within the pension space, which can encourage proactive retirement planning. Specifically, the following nine steps can be taken to improve member engagement and accelerate overall financial planning:

1. Understand inhibiting and promoting pressures
2. Create good choice architectures
3. Link to future self
4. Frame information carefully
5. Use social norms
6. Communicate differently
7. Link to life events
8. Develop and experiment with digital solutions
9. Make pension communication & member engagement a strategic priority

Research from Sweden shows younger people appreciate choice in investment funds significantly more than their older counterparts, but most do not choose. Moreover, people who have a higher appreciation for choice report higher expected financial well-being at retirement, whereas choosing a fund does not have a significant effect on expected financial well-being.

Nico Lacatera

Behavioural interventions can help overcome misperception, procrastination, information overload and present biases, all of which may prevent individuals from preparing adequately for retirement. Often, we are overly fixated on the immediate effects of having less money now.

Furthermore, too many choices can confuse people, and may lead to the selection of inferior and/or more expensive options. Behaviourally informed approaches, however, have been shown to effectively reduce complexity and improve the choices made.

Getting people to picture themselves in the future increases overall savings. Thus, initial intervention designs should emphasize the value of contributing now, include both positive and negative framing, and provide easily followed steps to prompt action. Later intervention designs should include sending reminders and the incorporation of positive social norms.

Rob Bauer

Utilizing different varieties of financial incentives on the same population, while holding the budget between treatments fixed, researchers found financial incentives to be effective extrinsic motivators to save. Moreover, larger and less frequent incentive amounts were found to be more effective than smaller more frequent ones. Financial incentives remain effective when used repeatedly.

Hot Topics:

There is such thing as too much member engagement. Too much bad news regarding plans can be counterproductive and possibly put members in an inactive state. However, good timing and frequency of information remains crucial to engagement and making informed choices. Next to financial incentives, reminders are most effective.

With the current generation being more consumption focused and the next being more saving focused, the pension industry will need to adjust its strategies accordingly. Early interventions to students will encourage them to start saving sooner, i.e. at age 20 rather than age 30. Of course, it is possible the social and environmental preferences of the new generation may not necessarily match their pension preferences.

The pension industry needs to broaden its perspective regarding financial skills and self-efficacy. It's imperative to implement different awareness, trust and relationship building strategies for different age groups, e.g Millennials and Gen Zs, expect to interact with everything online.

Actions:

- Give members access to a user-friendly platform and use clear and simple communications.
- Use behavioural interventions, focusing particularly on digital revolution, with structural and policy-led changes in DC to help people save more.
- Always test behavioural intervention messages before sending.

What Can We Learn From FinTech?

Todd Baker (Columbia University) and **Jorge López** (Miles to Retirement/Vitalis) explored how FinTech is changing the retirement space, and how plan sponsors can shape workers' pension saving, investment, and decumulation plans. **Carlo de Bassa Scheresberg** (Global Financial Literacy Excellence Center) addressed financial literacy and the impact of FinTech on Millennials' financial behaviour. **Karen Andres** (Aspen FSP) moderated the discussion.

Key Takeaways:

Todd Baker

Generally, people have similar financial and retirement needs in the FinTech space. However, for lower-income working families with volatile income and expenses, the need for immediate liquidity is greater than retirement and savings need. Low financial decision-making capability further compounds the long-term retirement saving problem.

The traditional financial education approach needs to be replaced with behavioural science. FinTech's ability to combine AI with aggregated bank data and behavioural insights can deliver effective and actionable solutions. Thus, DC providers should follow the FinTech example and create complete FinTech financial health solutions provided through employers.

Jorge López

There is a general trend of consumption over savings, and there currently are not enough programs to confront this problem. Miles for Retirement, created by Mexican actuaries, uses the existing network of financial service providers, consumers, and retailers to promote savings. With this platform, with each payment for a good or a service, a percentage of the amount spent automatically gets deposited into a retirement savings account.

By itself, the tool will not end the pension problem, but with optimal participation and effective communication to relevant audiences, the project serves as an effective complement to other retirement solutions. Improved investment governance not only increases the quality of decision-making and client relationships, but also helps to clarify roles and responsibilities.

Carlo de Bassa Scheresberg

Researchers examined data from two surveys to provide insights on the financial capability of American Millennials who use mobile payments. They found that mobile payment users are more likely to overdraw their chequing accounts, use credit cards expensively, borrow through alternative financial services, and withdraw from their retirement accounts. The findings highlight the importance of financial literacy as the FinTech industry expands.

Hot Topics:

FinTech will allow us to address gaps in the retirement space and make it easier for people to see a complete picture of their financial health. Power of data, behavioural psychology and analytic software can be used to foster better decision-making outcomes. This can be done by both large corporations and small start-ups.

Whether or not a company should partner with a FinTech firm depends on the company; however, partnering is not the only option. Acquisitions, competition and creating internal FinTech departments are alternative methods.

Actions:

- Shift focus to financial 'well-being' rather than financial 'benefits'
- Consider the impact of urgency on financial decisions and make retirement part of a complete financial health solution for consumers
- FinTech should be viewed as a complement to, not a substitute for, financial literacy

David John (AARP Public Policy Institute) and **Alex Mazer** (Common Wealth) discussed ways in which policy-makers, providers and the greater industry are moving beyond the traditional approaches to delivering DC. **Will Sandbrook** (NEST Insight) moderated the discussion.

Key Takeaways:

The Rainy Day Savings (RDS) Program offers automatic enrolment, payroll deduction emergency savings accounts to employees.

The AARP Public Policy Institute commissioned a national survey to shed light on employee demand for RDS Program and what features they wanted the accounts to have. It found that an employer match of emergency savings resulted in almost universal participation. It also found individual attitudes and opinions to be more important drivers of participation than demographic factors, as illustrated below:

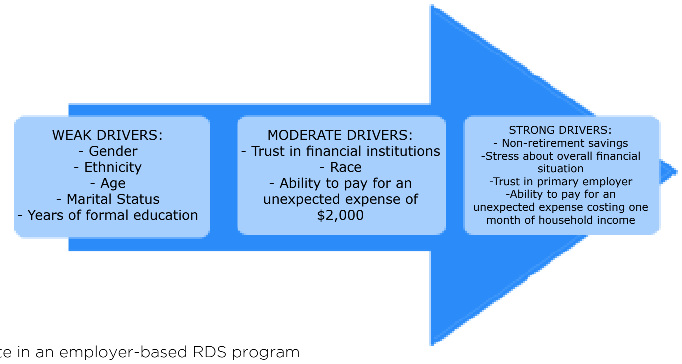

Figure 1: Drivers of likelihood to participate in an employer-based RDS program

A shifting economic landscape is driving significant changes in the workplace, which means we now need new retirement solutions for workers not covered by traditional workplace pensions.

Portable non-employer retirement benefits are an approach to expand coverage to cater to the needs of under-served groups, and are the subject of a recent report by the Aspen Institute's Financial Security Program in collaboration with Common Wealth. These benefits are sponsored by one or more organizations (e.g., unions, professional associations), open to both employees and non-standard workers, and portable from job to job. They are workplace-based, but not tied to a single employer.

The report reviews six different potential models for potable non-employer retirement benefits, each supported by a case study. It suggests a set of design principles for such benefits (members first, automatic, lifecycle, risk pooling), and recommends building a market for such benefits in the United States through a combination of pilots, funding streams, and policy reform.

Hot Topics:

Both income volatility and pressure on employers to offer more than pensions has been increasing. There is also a noticeable decline in traditional DB plans.

There are two main considerations to take into account when it comes to pension portability i.e. plans which stay with employees throughout through their financial lives. First, how long a person remains associated with the institution and, second, the institution's overall life span.

Increasing Trust and Transparency

Nick Callil (Willis Towers Watson) and **Elizabeth Kelly** (United Income) highlighted the ways providers and policy-makers can work to improve trust in pension saving, and what is the role of provider governance and structure. **Matthew Blakstad** (NEST Insight) moderated the discussion.

Key Takeaways:

Built-in DC systems generally breed distrust. Unfortunately, due to foundational issues, it is difficult to improve the situation with attempts to reduce complexity or increase the perception of transparency in the member's mind. Constant changing of policies can make matters even worse by causing people to mistrust otherwise sensible outcomes.

According to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, we need better supervision of the trustees overseeing superannuation assets, and the trustees must act in the beneficiaries' best interests.

The Productivity Commission's Inquiry into the efficiency and competitiveness of the Australian superannuation system identified numerous structural flaws. It prescribed a '10 best in show' system for allocating new workers to funds. Insurance inside superannuation to move to opt-in, rather than default. Shift towards smarter use of data to improve outcomes is slow because of a lack of data, the investment in technology required, and privacy legislation.
United Income's Efficient Investing™ approach provides individualized spending and longevity estimates, a personalized investment plan, and optimized government benefit recommendations.

Hot Topics:

Based on the results of the inquiries, it will be difficult to restore the people's faith in the system. The government must focus on rebuilding trust rather than eroding it.

Control is an important part in the trusting process, with people tending to need a level of control lying somewhere in the middle of the control spectrum. Insurance is another hot button issue, and an important factor in the overall offering; however, fewer funds include it presently.

Actions:

- Do what you say and don't over promise. Small interactions go a long way in building trusting relationships. Trust can be built by transparency and creating a sense of comfort.
- Ensure members are engaged with their retirement savings and understand the risks and benefits of their pension funds. This should help offset the uncertainty of future benefits.
- Interface and options should not be overwhelming. Offer simple, actionable solutions through interface to build trust.

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