Is your defined contribution plan ready for 2021 and beyond?

December 2020

Defined contribution (DC) plans have evolved over time, from being supplementary retirement accounts to becoming the main retirement savings vehicle for many Canadian employees. Today, the pace of this evolution is accelerating as DC plan sponsors work to achieve broader objectives and stronger outcomes, expanding resilience in a world of increasingly unpredictable risks and returns.

This article suggests potential action steps in three critical areas: design, investments, and governance, to help plan sponsors respond to both challenges and opportunities – in 2021 and beyond.

Design trends

Increasing flexibility

Over the course of the COVID-19 pandemic, most Canadian employers moved some of their workforce to offsite work, work-from-home, or in some cases reduced hours. We expect these experiences will likely impact retirement expectations, leading to slower and potentially smoother transitions into retirement, as phased, flexible, remote, and part-time arrangements have proven to be more feasible than previously thought. This has created a follow-on need for plan sponsors to reconsider appropriate spend-down solutions for their older workers and near-retirees, as both a means to support part-time retention, and orderly departures from the workforce.

Part of the solution might include variable benefits, which are now permitted in all Canadian jurisdictions except New Brunswick and Newfoundland. Variable benefits allow members to keep their DC account balances in their employer's plan during the drawdown phase, and to receive retirement income, subject to minimum and maximum limits on annual withdrawals. The advantages of this arrangement include peace of mind for employees, who benefit from their employers' oversight of the plan's investment options, and the ability to increase retirement income through the lower fees typically negotiated by employers over retail products.

Some employers, however, may decide that only modest changes are needed, perhaps rebalancing employee needs between the short- and long-term. For example, this might mean adding or promoting a Tax-Free Savings Account (TFSA) option to help plan members build an emergency cash reserve. In either case, increasing flexibility across all types of benefit plans, while previously a trend, has now become a best practice.

Leveraging virtual employee decision support

In the current economic environment, employees are facing complex financial decisions about how much to save and invest, how to finance existing debts, and how much risk to take on, in addition to trying to figure out how to prepare for retirement – or delay it. Good DC benefit planning – where communication and decision support tools are part of the design – can start to address some of these often-paralyzing choices through virtual tools that help employees make better informed decisions, along with "nudges" to encourage enrollment, periodic contribution increases or reminders to review default fund selections.

However, like other aspects of wellbeing, financial wellbeing requires ongoing commitment, and potentially investment of resources to monitor and manage outcomes. This, however, does not have to be costly. For example, in resource-constrained times, focusing on benefits and solutions already available can go a long way towards helping employees make informed decisions about their retirement financial security.

Investment trends

Incorporating ESG

Environmental, social and governance (ESG) considerations have quickly become important evaluation criteria for the asset management industry, reflecting broader investor interest and demand. Similarly, employees are increasingly expecting to see their values and beliefs reflected in the activities of their employers – and in their organization's retirement plan investment options. The past year has seen a sharp rise in the promotion of terms such as "responsible" and "sustainable" investing, including "ESG funds" and "impact investing", which use various environmental, social or governance criteria to determine funding.

We believe a focus on sustainability will produce better outcomes over the longer term, and expect to see more plan sponsors fielding questions from their members on this topic, both with regard to fund selection, and potentially with regard to the ESG commitment levels of the asset managers themselves. Importantly, as institutional investors see more pressure to align their strategies with the global response to climate change, employers may want to review their fund options for the purposes of their own organizational response, and for member engagement in the plan.

Making investments work harder and smarter

DC investment portfolios can become outdated over time. As plan objectives evolve, portfolios should be adjusted to remain fit for purpose. While we will always face systemic risks, whether they are economic, societal or environmental, thinking carefully about risk tolerances, investment diversity, removing unrewarded risk, and managing liquidity will provide more resilient and, ultimately, more successful portfolios. Focusing on diversification and constructing a portfolio to help maximize risk-adjusted returns can be an efficient way to champion long-term results while protecting members from short-term market dislocations.

Looking under the hood of investment options is a key exercise in understanding the fund's risk posture. For example, the asset mix of typical target-date funds (TDFs) is dominated by publicly traded equities, investment-grade fixed income and short-term investments. Some TDF providers will target allocations to diversifiers, such as real estate investment trusts, inflation-protected securities and infrastructure. Historically, DC plans haven't utilized these types of investments due to their illiquidity, pricing, fees and governance requirements. However, sponsors, consultants and investment managers can judiciously add these asset classes to further diversify the current generation of TDFs while enhancing risk-adjusted returns for participants.

Governance trends

Measuring financial stress

According to Willis Towers Watson's Global Benefits Attitudes Survey, nearly 40% of Canadian employees could not come up with $3,000 if an unexpected need arose. Financial insecurity and its implications for productivity and orderly retirement are concerns that are within the ability of an organization to mitigate. The first step is to size up the problem. By using employee analytics, plan sponsors can gain clarity on where financial vulnerabilities may lie, how they differ across the workforce, and identify employee segments for targeted action.

But measuring financial stress isn't only about the numbers. Employees also want to be heard. We find some of our highest survey participation rates are achieved through employee listening activities. People want to connect – especially with more employees working from home or remotely. Pulse surveys and technologies such as virtual

focus groups can provide deeper insight into financial challenges and solution preferences. At the same time, listening demonstrates that business leaders care about their employees' wellbeing.

Addressing post-pandemic operational risks

Plan sponsors and members have experienced changes over the past few months. While challenges remain, we believe that sponsors should not lose focus on compliance. Many plans have experienced material changes over a short period of time; even where this hasn't happened, plan sponsors have likely shifted their attention to other business matters. Add to this the reality that recordkeepers have also seen changes across their business and client base, and you have a situation ripe for operational missteps

Plan sponsors can effectively manage their risk by taking a variety of steps to assess operational compliance and vendor performance. Conducting a limited scope operational review will allow plan sponsors to ensure that post-crisis administration is operating effectively. During the response to the pandemic, plan provisions were in some cases changed. In addition, temporary leaves or layoffs were frequently introduced. A review assessing the impact of these actions will ensure that statutory requirements are met, and potential inaccuracies do not become embedded and lead to future burdensome operational issues. We believe taking these steps now can pay dividends later from a risk management perspective.

Managing increased cyber risk

DC plans can be vulnerable to cyberattacks on several fronts. Whether it's a data privacy breach or a direct attack on participant accounts, the stakes are high for participants and plan sponsors alike. And those stakes have been raised significantly as more plan participants work from home in less technologically secure environments that are more susceptible to cyber risk.

We encourage sponsors to assess the third-party risk inherent in plan administration. This assessment should focus on a DC vendor's critical systems, remediation protocols, workforce training and overall financial commitment to cyber security. Sponsors should also look to experts who can help evaluate controls, identify security gaps, review contract language, assess insurance coverage and benchmark vendor capabilities against other providers. Like any other fiduciary obligation, reviews of cyber security should have a place on plan committee agendas and be thoroughly documented.

Conclusion

In many ways we are entering a new era of benefits management – one more centered on employee voice and choice. Employers, too, have an opportunity to review their role, and the choices they want to make about the design, operation and funding of their plans. While we've outlined several facets to consider, we expect additional evolution in this space, as plan sponsors work to better address employees' needs and expectations – in 2021 and beyond.

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