

# Panel 2

## Decumulation Options – Plan Design Considerations

Moderator:

*Phillip Haggstrom, Acting Manager of Pensions, BCFSA*

Panel members:

*Brendan George, George & Bell Consulting*

*Barbara Sanders, Simon Fraser University*

*Neil Lloyd, Mercer*

# Decumulation: Regulator's Perspective

- Want the focus to be on effective decision making for both in-plan and out-of-plan options
- DC Plans need to prepare their members for retirement regardless of their plan's decumulation options
- Encourage in-plan options though recognize the greater governance requirements

## In-Plan Options

Variable Payment Life Annuities (VPLAs)

Life Income Type Benefits (LITBs)

## Out-of-Plan Options

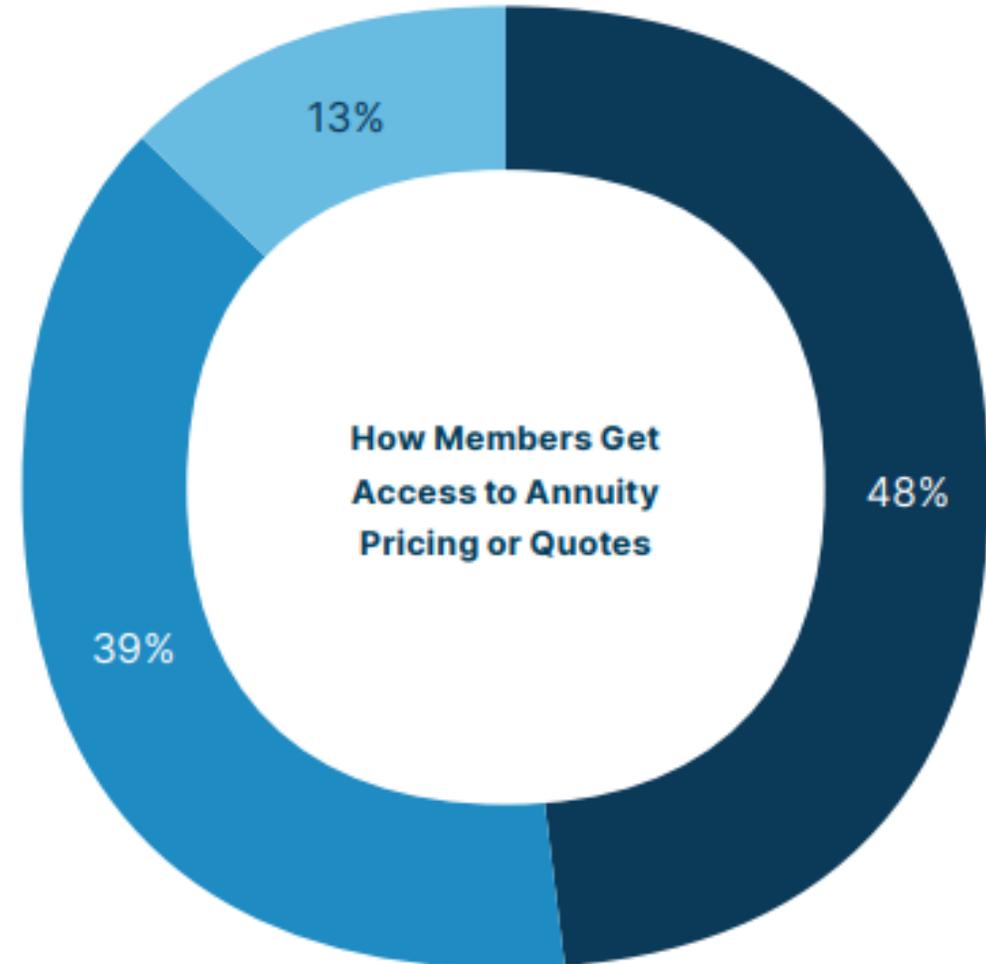
Annuity Purchase

External transfers (e.g. LIRA, RRIF/LIF)

# DC Survey Highlights

## Decumulation Decisions

- It is left up to the member to obtain annuity pricing/quotes without assistance from a plan/provider
- The member is offered an annuity from the plan's existing fundholder, without a 'bidding process' that is facilitated by the plan/service provider
- The plan or plan service provider facilitates a 'bidding process' for the member



# CAPSA Decumulation Committee

- Mandate: Harmonized VPLA framework
- Application to Defined Contribution and Pooled Registered Pension Plans (“PRPPs”)
- Committee will:
  - Develop recommendations for legislative amendments to pension standards legislation, including PRPP legislation
  - Consider developing regulatory guidance

# Variable Payment Life Annuities

- Bill C-30 amendments to ITR
- Pension payments vary based on experience: investment and mortality
- UBC Faculty Pension Plan
- Issue: How to regulate VPLAs?

# Panelist

*Brendan George*

*Partner - George & Bell Consulting*



October 13, 2022

# BCFSA Pensions Forum

## DC Plan Payout Options: Plan Design Ideas

Prepared By: Brendan George

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**George & Bell**  
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# Agenda

- The Issues
- Potential Plan Design Solutions
- DC Conversion to Target Benefit Plan
- Hybrid Plan Design

# The Issues



# The Issues

- Current challenges with DC Plan decumulation vehicles:
  - High fees (and lack of disclosure) if members leave their group plans
  - Complicated decumulation vehicles: LIF, annuity, VPLA
  - Willingness / ability of members to manage their investments forever (2008, 2022, ...)
  - Lack of diversification of traditional investment funds
  - Lack of risk pooling (investment, longevity)
  - Lack of independent investment advice for members
  - Plan sponsor willingness to find a solution for ex-employees?

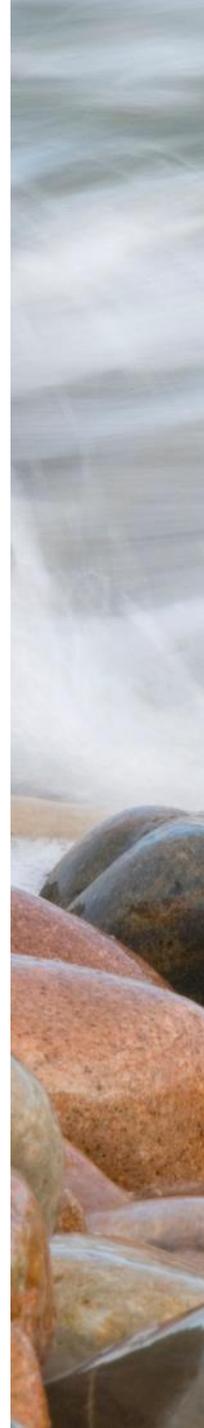
# Potential Plan Design Solutions



# Plan Design Solutions

- Target Benefit Plan (TBP)
  - Fixed contribution rates (member/ employer)
  - Acts like a DC plan for employer, DB(ish) plan for members
  - Target lifetime pension at retirement (formula based on contributions / earnings)
  - Retiree indexing possible if funding sufficient
  - Benefits on death, termination, early retirement based on lifetime pension
  - BC PBSA requires funding test every 3 years which may result in change in benefits
  - Able to convert DC plan to TBP for past and future service
- Hybrid: DC for accumulation, TBP for decumulation

# DC Plan to Target Benefit Plan Conversion



# Pros and Cons of Conversion

- **Pros**
  - Pays predictable retirement income more efficiently than purchasing an annuity
  - Allows members to share risks, particularly investment and longevity risks (i.e., chance of running out of money in retirement)
  - Access to alternative investments (real estate, infrastructure) that may not be available to individual investors

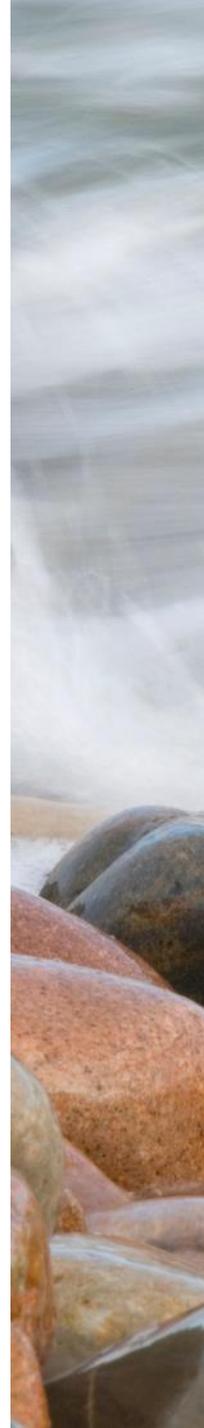
# Pros and Cons of Conversion

- **Cons**
  - Members cannot direct their individual investments
    - Assets are pooled and invested professionally, with oversight by Trustees or sponsor/employer
  
  - Assets cannot be passed to future generations upon death, other than a survivor pension to spouse or guaranteed payments to beneficiary
  
  - Target Benefit pensions are not guaranteed
    - Benefits may have to be reduced in the future if contributions not adequate
    - But they can also be increased if legislated thresholds are satisfied
  
  - Time and cost to undertake conversion

# Conversion Process

- Member communication and feedback (member vote in some cases)
- TBP plan design costings, decisions and documentation
- Governance structure
- Funding and investment policies
- Present members with DC account balance options (remain DC / convert to TBP)
- Review of plan's service providers
- Regulatory filings
- Typically 1 year to complete implementation

# Hybrid Plan Design



# Hybrid Plan Design

- DC plan design for accumulation period while working:
  - Employer and members contribute fixed % of earnings
  - Members have individual DC accounts that accumulate with investment earnings
  - No investment choice, all members receive the fund rate of return
- TBP plan design for decumulation period in retirement:
  - Member account balances converted to lifetime pension at retirement based on plan rules
  - Pension is a target benefit, not guaranteed
  - Members do not have an option to withdraw account balance in a lump sum
  - Funding test required every 3 years to determine sufficiency of assets to fund target benefits, whether benefits should be changed

# Thank You!

- Contact Information:
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georgeandbell.com



# Panelist

*Barbara Sanders*

*Associate Professor, Department of Statistics and Actuarial Science - Simon Fraser University*

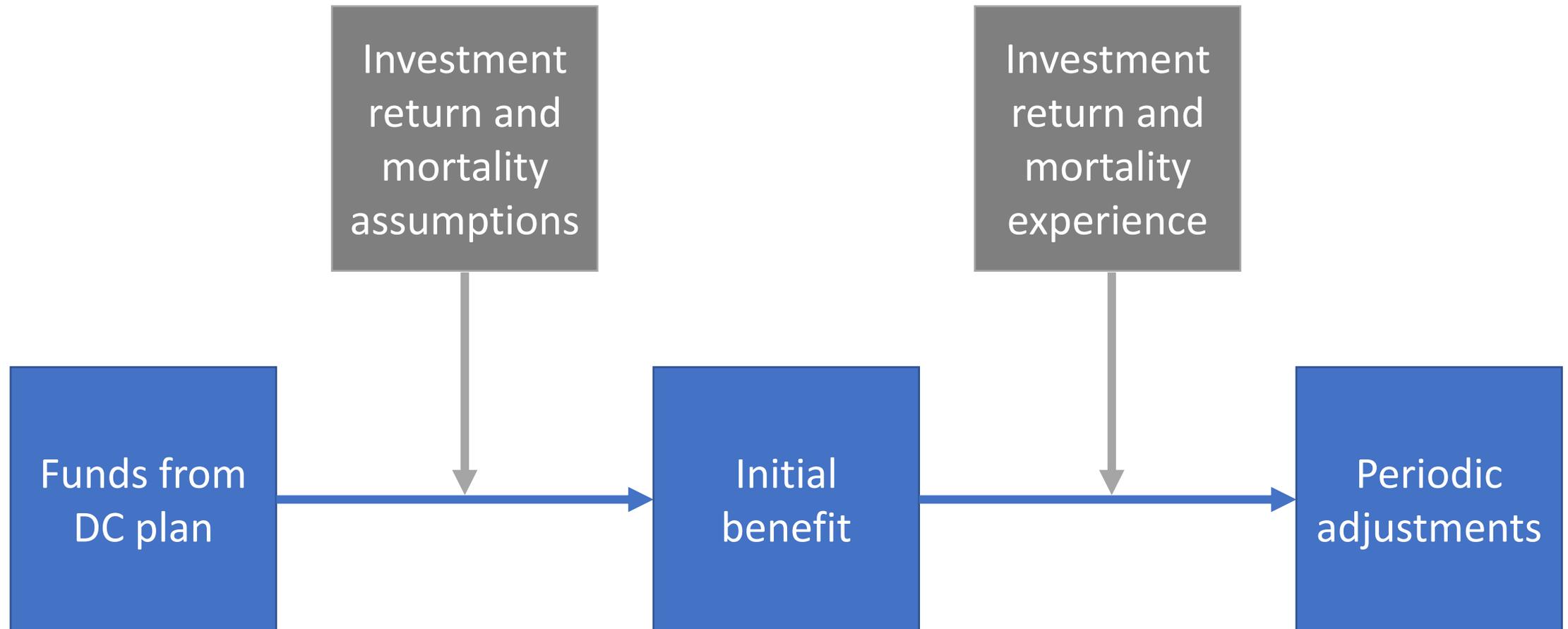
# VARIABLE PAYMENT LIFE ANNUITIES

Barbara Sanders, FSA, FCIA

BCFSA Pensions Forum  
October 13, 2022



# How a VPLA Works



# TBP vs. VPLA

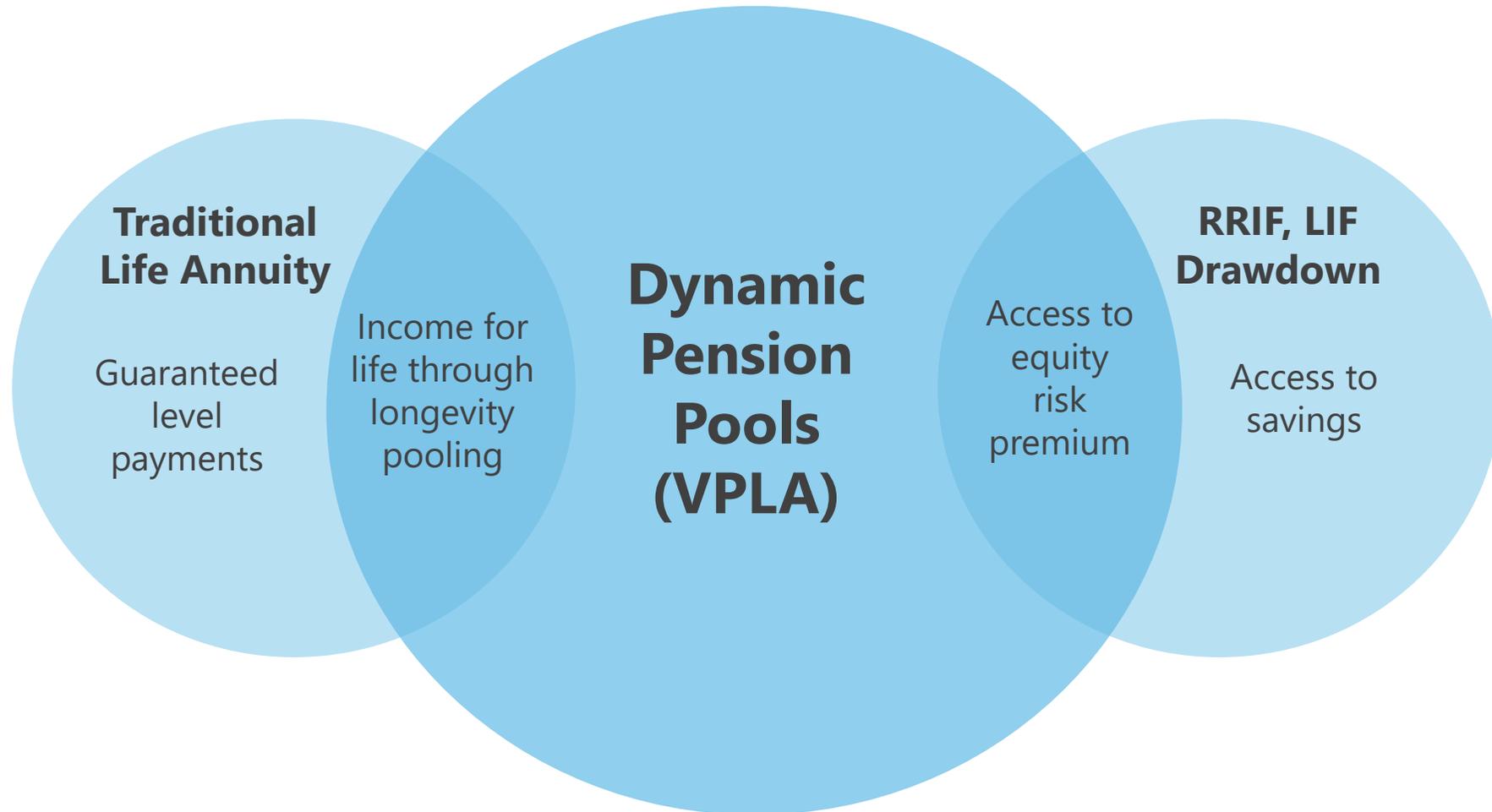
	Target Benefit Plan	VPLA
Income for life?	Yes	Yes
Benefit amount	Not guaranteed, adjusted from time to time	Not guaranteed, adjusted from time to time
Types of members	Actives and pensioners	Pensioners only
Contributions	Ongoing during working life	Lump sum at retirement or later
Complexity	Higher	Lower

# UBC Faculty Pension Plan



A successful  
example operating  
since 1967

# Member Perspective



# Sponsor Perspective

- Provides lifetime pension income
- Retains assets in pension plan
- Maintains relationship with retired employees
- No benefit guarantee from plan sponsor

# Implementation Options

1. VPLA inside a defined contribution plan
2. VPLA inside a PRPP
3. Standalone pool (?)

# Next Steps – Legal

- Provincial legislation
- Tweak to ITA to allow standalone pools

# Next Steps – Sponsors

- Explore alignment with benefit objectives/philosophy
- Design
- Recordkeeping
- Member support with decision-making (advice)
- Advocacy

# Panelist

*Neil Lloyd*

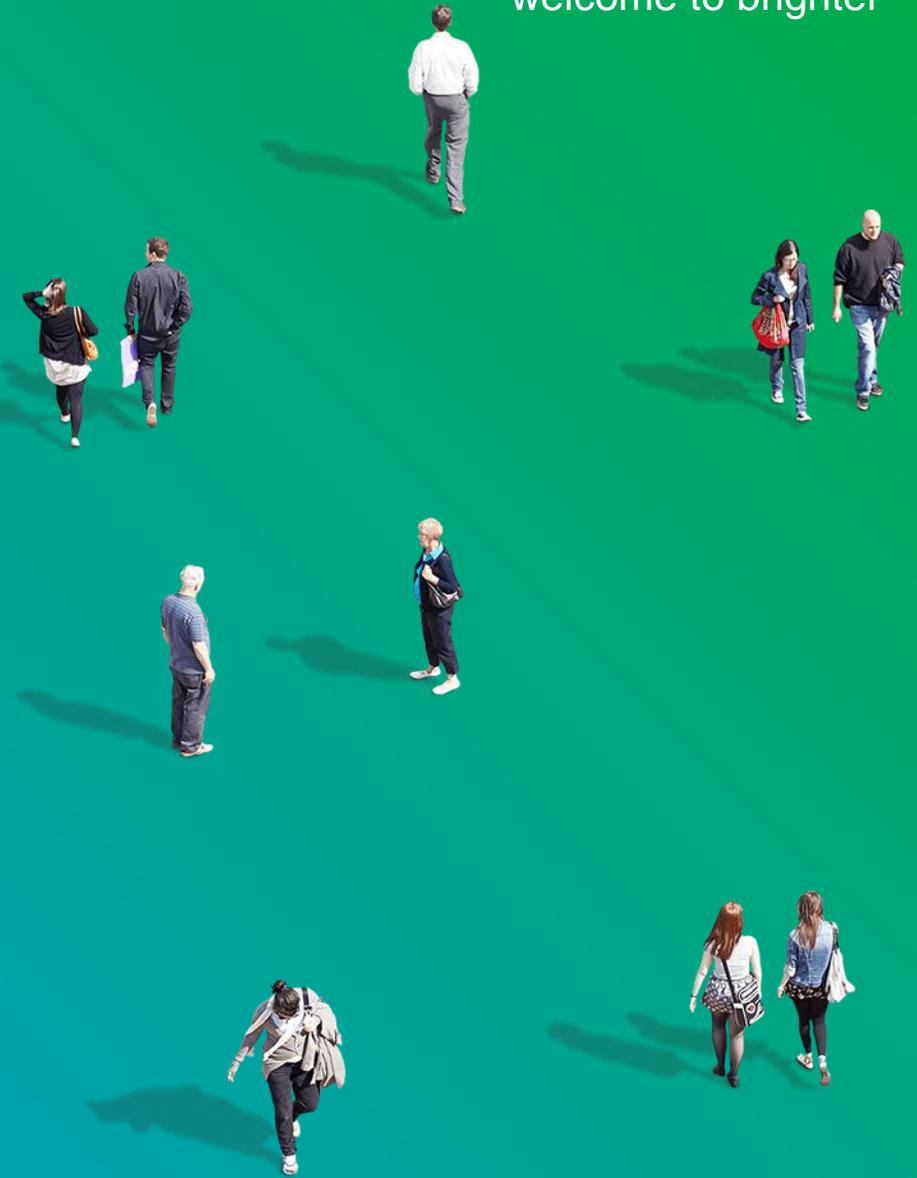
*Partner, Western Canada Wealth Leader - Mercer*

# Retirement Income Experiences

BC Pensions Forum

October 2022

Neil Lloyd, Western Canadian Wealth Leader, Vancouver



“As we develop retirement solutions a lot can be gained by **understanding what retirees are actually looking for** (not what we think they should be looking for), and the **experience of how retirees currently use products** can be very helpful and should not be ignored.

The reality is that the **diversity and individuality of retiree needs** is often overlooked and decumulation is far less an academic, engineering or actuarial problem but **a very personal issue** subject to many **behavioral challenges** – a far more tricky problem to solve.”

# Myths and realities and behavioral considerations



# Understanding retiree needs and wants

Consider the realities not the myths

## Myths

Retirees are all the same – a “one size fits all” works well

Retirees like active participants are disengaged

In retirement all retirees need is an inflation-linked income, income is a retiree’s focus

Plan sponsors need to provide a comprehensive solution to retirees’ needs

## Realities

Retirees are not the same – they have diverse needs and require diverse solutions.

At retirement, retirees do take the time – they are engaged

Retirees income needs typically decline into retirement, and asset preservation seems very important

Any well thought through advice is incrementally helpful

**Focus on their actions (“say-do” paradox)**

For more information on the “Myths and Realities of Retirement” see this [article](http://bit.ly/2UrNFWq) that appeared in Benefits Quarterly <http://bit.ly/2UrNFWq>

# Behavioral influences: Endowment (wealth) effect

Where people tend to value more highly something they own more than something they do not (even if they are equivalent)



This may explain why a person who has built up say \$500,000 does not want to lose that wealth:

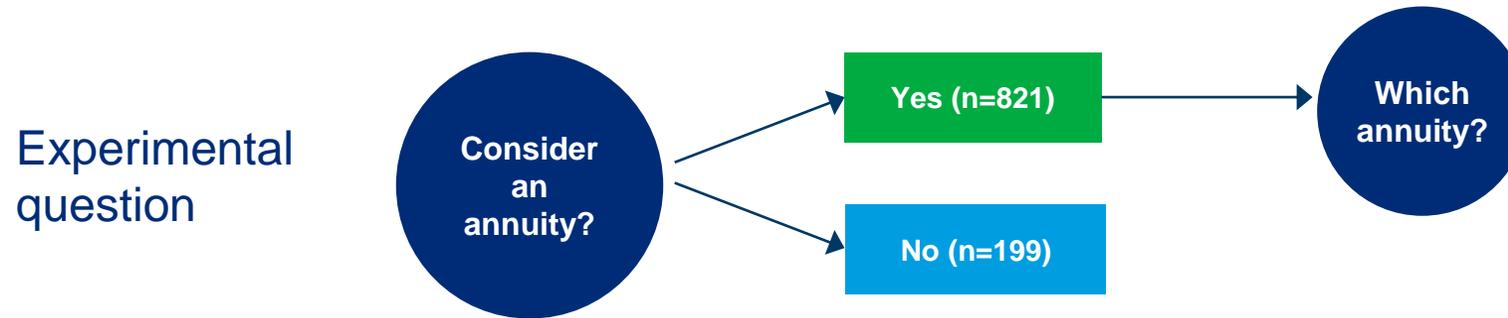
- Negative view if depleting wealth by transferring say \$250,000 to an annuity
- Explains why US experience is that on average retirees tend to maintain wealth into retirement (not spending down capital into retirement)

Knetsch, Jack L. (1995). "Asymmetric valuation of gains and losses and preference order assumptions". *Economic Inquiry* 38, 138–141.

# Research by behavioral scientists

Suzanne Shu researched who says they are interested in an annuity

A substantial proportion of respondents do not like annuities at all (~20% across all tasks)



Who never picks an annuity?

- No significant effects of age, education, or income
- Annuities disliked by individuals with highest savings (>\$150K), with the **highest risk aversion (risk aversion is the risk of passing away and not using their retirement assets)**
- Annuities most strongly disliked by those who see them as unfair

Very interesting to observe what risk many retirees wish to avoid (that endowment effect again?). The real risk being what if they die early (this comes through time and time again).

Also note the “unfairness” stigma that can attach to annuities

Source: Suzanne Shu, DCIIA Webinar, August 22, 2019, “How Behavioral Finance and Psychological Biases Can affect Retirement Income Decision Making”

# The breadth of risks facing retirees

## Society of Actuaries: 2020 Retirement Risk Chart

Economic risks	Personal planning considerations	Unexpected/unpredictable events
Inflation	Longevity	Public policy changes
Interest rates	Post-retirement employment	Significant health care needs
Financial markets	Changes in housing and support needs	Unforeseen needs of family members
Employer solvency	Change in marital or partnership status: Death	Bad advice, fraud or theft
	Change in marital or partnership status: Divorce, separation or remarriage	

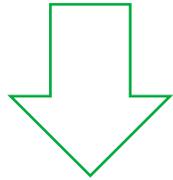
The breadth of risks facing retirees coupled with the long time horizon leads to a rational response: the need for a retirement strategy that can be flexible and adapt as needs change.

Most retirement solutions or thinking focus on inflation, interest rates, financial markets, longevity and maybe health care. But focus groups and surveys show that retirees have a broader set of uncertainties.

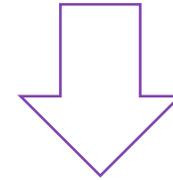
# Start by considering what retirees are looking for

And what influences their decisions

Too many solutions start here  
WE KNOW WHAT RETIREES  
SHOULD WANT?



More solutions should  
start here



What happens when you listen to retirees or see what they are doing?

**What can we learn from  
the experience of other  
countries?**

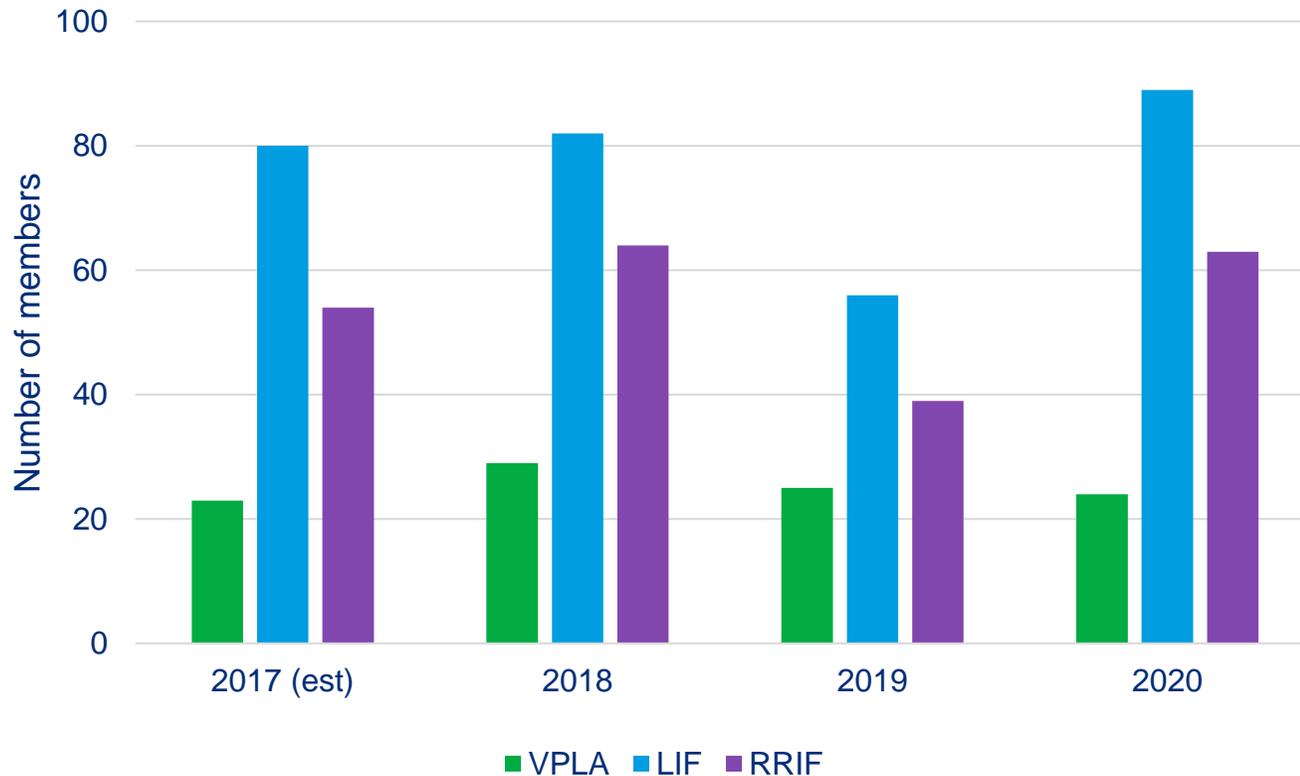
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# Canada: Case Study 1

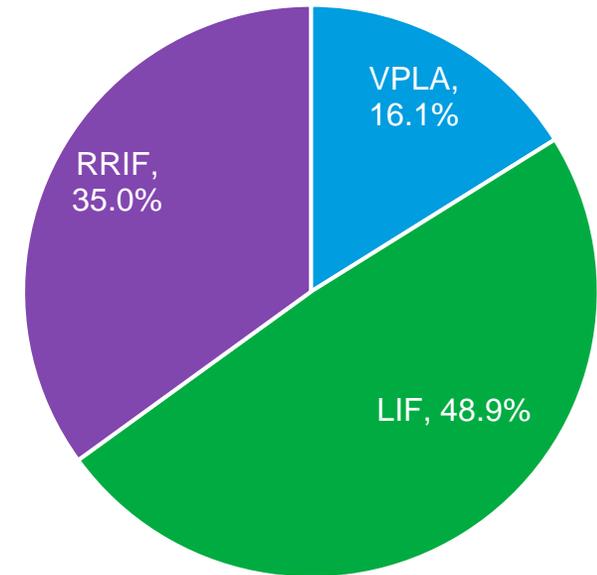
Renowned for offering Variable Payment Life Annuity

Only 16.1% take VPLA and per 2016 less in assets

### Retirement Incomes Started in Year



### Experience 2017-2020 % of members



VPLA is clearly a benefit of value (16% selected it) but it is not the dominant selection, and even less so when considering assets.

# Canada: Other case studies

## Case Study 2

- Offer Variable Benefits and Internal Variable Annuities
- From their Annual Report:

Benefit Payments : Number of Members			
	2018	2019	2020
Variable Benefits (VB)	508	527	541
Internal Variable Annuities (IVA), no DB	127	131	157

## Case Study 3

- Offer Variable Benefits and Fixed Annuities

New VB Starts	New Monthly Pensions
Total funds : \$108,287,255	Total funds: \$22,629,949
Average funds : \$240,638	Average funds : \$155,000
Number : 450	Number : 146

**Annuities are typically not the preferred selection of choice, BUT some retirees do select them.**

Annuities whether fixed or variable do add to the range of retirement income options some retirees desire.

# United Kingdom: What can we learn from UK experience?

## Pension Freedom

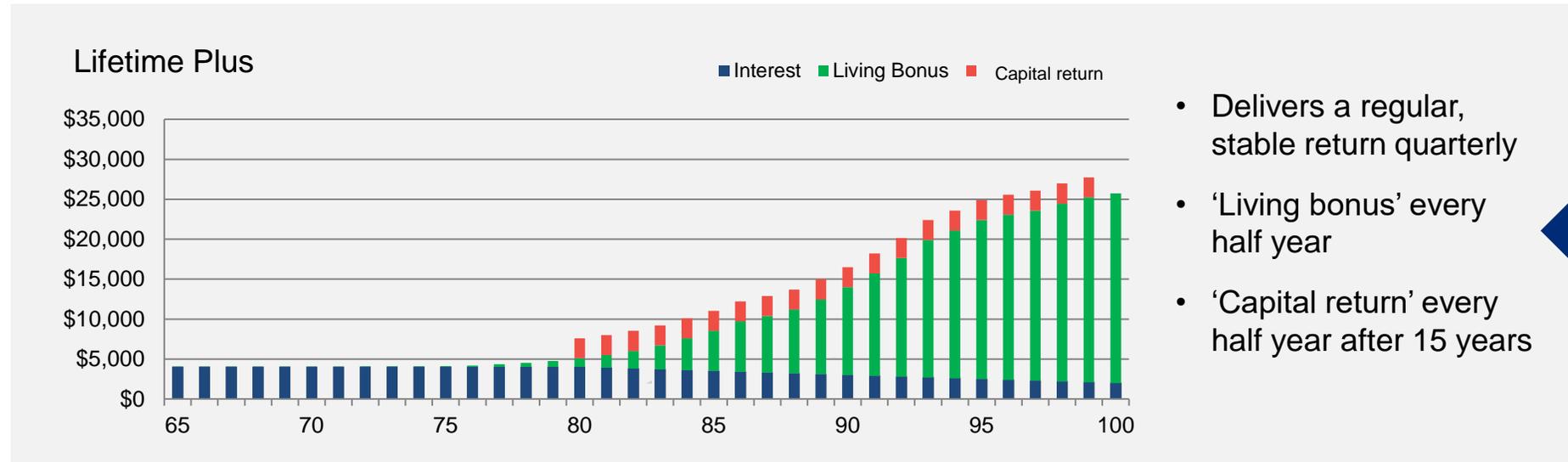
- “According to a 2018 article<sup>1</sup>:
  - “...while about 90 per cent of people bought an annuity back in April 2015, now a mere 12 per cent are choosing an annuity, 34 per cent are remaining invested and drawing from their pension and 54 per cent are cashing in their whole pension.”

Reinforces how, given the choice, retirees typically do not select an annuity.

<sup>1</sup>[State of the annuity market 3 years after Armageddon - FTAdviser.com](https://www.ftadviser.com/news/state-of-the-annuity-market-3-years-after-armageddon/)

# Australia: Mercer Lifetime Plus

World's first mutually-pooled longevity risk solution (and won several awards)



- Delivers a regular, stable return quarterly
- 'Living bonus' every half year
- 'Capital return' every half year after 15 years

← Pooling of mortality credits

Despite awards and academic acclaim, Lifetime Plus was not a success and is no longer offered (for now).  
Why? Complexity, limited advisor incentive, communication.  
In testing : participants seriously disliked that others benefited from their early death (the "living bonuses")

Solutions need to avoid complexity and need to be simple to understand.  
Longevity risk pooling is attractive as long as you benefit, if not it may be disliked and considered unfair.

# Australia: The QSuper response

## Key features

- A variable annuity that took inspiration from BC
- 2 key design principles : Compelling and Simple
- Product design was focus group tested

Designed to be used together with a traditional drawdown strategy



## Recap of product features

QSuper Lifetime Pension



### Income for life

Fortnightly payments for the rest of your life



### Optional spouse protection

Payments continue if you pass away



### Higher income

Market linked with an annual adjustment<sup>1</sup>



### 6-month cooling-off period

Providing time to decide if it's right for you



### Potential Age Pension benefits

Discounted assets test



### Money-back protection

Receive at least your money back as income or the remainder as a death benefit<sup>2</sup>

Expectation was that:

- Members with limited savings can rely on Age Pension (i.e. do not need Lifetime Pension)
- Members with adequate savings will be self-sufficient (i.e. do not need Lifetime Pension)
- Lifetime Pension would be for those members in between

<sup>1</sup> Income can go up or down depending on pool performance. <sup>2</sup> Subject to a legislated maximum in limited circumstances

Note participant feedback repeatedly shows the importance of a death benefit to address the severe risk of what happens if they die early

# Australia: The QSuper response

## Who really uses Lifetime Pension?

### Who is it REALLY designed for?



**Ravi, \$180k**  
"My greatest fear is being financially reliant on others in my old age."

**Rachel, \$250k**  
"I'm not very good with money, I'd love a reliable income that never runs out."



**David & Rosemary, \$600k**  
"This would be ideal – giving us higher income with a bonus of the age pension benefits."

**Amanda, \$800k**  
"I'm looking for the same peace of mind in retirement as I've had with my DB account."



**Linh & Trang, \$1m**  
"Just tell me how much I need to put in to get a Pension Concession Card."

**Michael & Lisa, \$2m**  
"I want to set Lisa up with a Lifetime Pension for peace of mind after I'm gone."



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*\*Fake photos and names*

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Key learning is that individuals have their own reasons for making decisions that cannot always be predicted.

While the decisions may not always appear as expected, for themselves they may be good choices that either give greater comfort or greater satisfaction.

# US Response: The retirement tier

Need to consider the full range of solutions available to help retirees and consider their linkages

## Resources: Recordkeeping

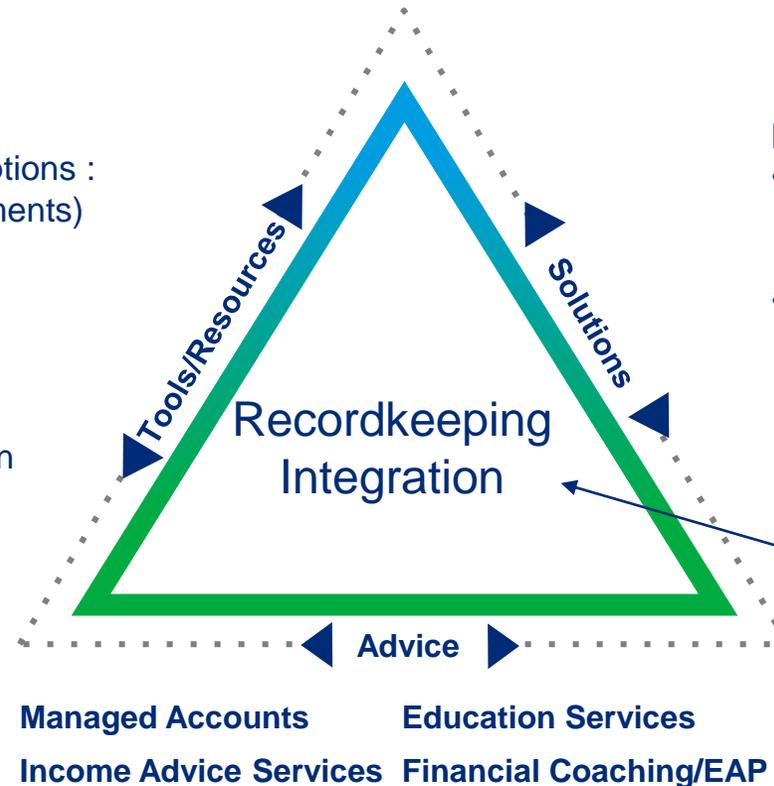
- Targeted Communication
- Plan Design (withdrawal options : lump sums vs regular payments)

## Tools & Coaching

- Social Security Optimization
- Retirement planning and projection tools

## Retiree Focused Investments

- Guaranteed: TDF with integrated income, in and out of plan annuity solutions
- Non-Guaranteed: Income oriented portfolios, managed payout funds



Recordkeeping platform is typically the connection point to the participant



- A comprehensive retiree focused solution will be a blend of tools, advice, and solutions
- Integration is key, particularly with record-keeper
- The solution may or may not include a specific investment product
- Key is offering something retirees are interested in and will engage with

# Conclusion

# 4

# Conclusion

1. Behavioral influences abound
  - But they may be a logical response to the uncertainty of life and a long retirement
2. Try and ascertain what retirees are actually looking for and what influences their decisions
  - Don't just focus on what we think retirees should be looking for
3. Look at the experience of how retirees currently use products
4. Do not overlook:
  - The diversity and individuality of retiree needs
  - That retiree selections are a very personal issue (and more logical than we may think)

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