WHAT'S THE MAGIC NUMBER FOR DC CONTRIBUTIONS?

It's clear that many employees need to save more, but while increasing contributions is an efficient way of boosting retirement accounts, experts says it's not always the right answer.

By Sonya Felix

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Back in the 1990s, senior management at the Co-operators Group Ltd. decided to be more generous with its defined contribution pension plan. While most Canadian companies with defined contribution offerings match employee contributions — often up to five per cent of salary — the Co-operators upped its plan on both sides of the equation by putting in even more than the members.

As Michael Dodd, director of pensions, treasury and shareholder services for the Guelph, Ont.-based company, explains, employees can choose to contribute six per cent and receive a 7.5 per cent match for a total of 13.5 per cent. They can also choose a five per cent contribution with a 6.5 per cent match for a total of 11.5 per cent. "From conversations with my peers, I believe this is quite generous," he says.

"Most of our employees select the first option and, although some younger employees complain that it is expensive, they adjust to the money coming off their pay and appreciate the result of higher contributions over time."

The plan is mandatory after five years, but Dodd says most employees sign up right away, partly because of word of mouth when long-term staff encourage new hires to get in early. More than 20 years after raising contribution rates, senior management remains committed and internal company surveys show members view the plan positively.

The Co-operators' contribution strategy is old news at that company, but with a greater emphasis on retirement income adequacy, there's a lot of talk in the pension industry these days about how to get employees to save more. And that brings up a number of questions: Should everyone contribute more to their plan? How high should rates go? Is there a magic number for contributions?

The case for increasing contributions

Multiple factors support increasing contribution rates to improve retirement incomes. Greater awareness of the importance of workplace savings is one driver, says Matthew Williams, head of institutional and client service at Franklin Templeton Investments Corp. "Employers also recognize that to attract and retain employees, they need a more compelling compensation package."

Others in the industry note that higher contributions could help make up for the low market returns during the past decade. Janice Holman, who leads the defined contribution consulting group at Eckler Ltd., says data shows the same plan (in a balanced fund) would deliver significantly higher replacement income for someone who retired in 2006, versus someone who left the workforce today.

"This is due to lower interest rates today, increased longevity of Canadians and the market returns someone would have experienced over the past 25 years compared to the 25-year period ending in 2006," says Holman. "It is just harder to produce retirement income today than it was in the past. Employers are concerned that the workforce won't be able to successfully transition to retirement and are therefore trying to get employees to save more."

There's also some concern among employers about who may shoulder the blame if plan savings don't provide enough retirement income. "A large proportion of corporate plan sponsors feel exposed to the risk of liability, especially since there are no robust regulations here in Canada," says Brad Hicks, managing director of Canada at MFS Investment Management Canada Ltd. "When you look at the three pillars of an individual's retirement income — government, workplace and personal savings — talk these days puts the workplace portion front and centre."

Getting to the magic number

Globally, defined contribution pension plans are already moving towards higher contributions, according to Rob Bauer, professor of finance at Maastricht University in the Netherlands and executive director of the Toronto-based International Centre for Pension Management. "Most people are not saving enough for retirement, so it is important not to make a mistake on contribution rates. Saving 10 per cent a year is not adequate for a 60 to 70 per cent replacement ratio, and I believe DC contribution rates should be similar to a [defined benefit] plan with 18 to 20 per cent a year going into the plan."

Not everyone takes such a hard line, but there's anecdotal evidence that Canadian employers are moving contribution rates higher than the standard plan of equal contributions of three per cent, says Williams. "We are typically seeing a higher percentage in public sector plans where there is an element of forced participation. For example, one provincial DC arrangement has a mandatory nine per cent contribution and nine per cent match. That drives some large balances for individuals with longer tenure in absolute-dollar amounts."

2016 PENSION ASSETS (MILLIONS) ARE AS OF DEC. 31, 2016; 2015 PENSION ASSETS (MILLIONS) ARE AS OF DEC. 31, 2015

▲▼ Indicates an increase or decrease in assets from 2015 to 2016

TOP 50 DEFINED CONTRIBUTION PLANS

Rank	Plan	Rank 2015	Change	2016 PA	2015 PA
1	THE PUBLIC EMPLOYEES PENSION PLAN (SASKATCHEWAN)	1	▲6.1%	$8,967.4	$8,451.0
2	CO-OPERATIVE SUPERANNUATION SOCIETY PENSION PLAN	2	▲7.2%	$3,577.3	$3,336.8
3	UNIVERSITY OF BRITISH COLUMBIA FACULTY PENSION PLAN	3	▲6.5%	$2,139.0	$2,009.2
4	COSTCO WHOLESALE CANADA INC.	5	▲19.2%	$1,384.2	$1,161.0
5	SOBEYS INC.[1]	8	▲25.7%	$1,296.6	$1,031.6
6	IBM CANADA LTD.	4	▲1.1%	$1,222.0	$1,209.0
7	MANULIFE FINANCIAL	7	▲9.3%	$1,175.0	$1,075.0
8	WESTERN UNIVERSITY	6	▲0.7%	$1,114.3	$1,106.2
9	THE CO-OPERATORS GROUP LTD.	9	▲7.9%	$1,004.3	$931.1
10	ROYAL BANK OF CANADA	11	▲8.5%	$965.7	$889.8
11	UNIVERSITY OF SASKATCHEWAN	12	▲6.8%	$776.9	$727.2
12	BOMBARDIER TRUST (CANADA)	13	▲5.9%	$716.5	$676.6
13	CLAC RETIREMENT PLANS	14	▲12.3%	$669.0	$595.9
14	ACTRA FRATERNAL BENEFIT SOCIETY*	15	▲7.6%	$623.3	$579.4
15	QUEBECOR MEDIA INC.	16	▲0.5%	$559.4	$556.6
16	MANITOBA SCHOOL BOARDS ASSOCIATION	18	▲10.1%	$540.2	$490.6
17	HUDSON'S BAY CO.	17	▲1.5%	$517.5	$510.0
18	TECK RESOURCES LTD.[2]	19	▲6.6%	$486.1	$456.1
19	FINNING INTERNATIONAL INC.	21	▲13.0%	$422.7	$374.0
20	ATCO PENSION FUNDS[3]	23	▲13.8%	$390.8	$343.5
21	SASKATCHEWAN PENSION PLAN	25	▲9.8%	$371.0	$337.9
22	POTASH CORP. OF SASKATCHEWAN INC.	20	▼-5.0%	$368.5	$387.7
23	CASCADES INC.	22	▲4.3%	$365.0	$350.0
24	GOVERNMENT OF NEWFOUNDLAND AND LABRADOR	24	▲5.1%	$356.5	$339.1
25	SUN LIFE ASSURANCE CO. OF CANADA	27	▲16.0%	$345.9	$298.2
26	AGRIUM INC.	26	▲6.6%	$343.2	$322.0
27	CANADIAN YMCA RETIREMENT FUND	29	▲7.3%	$311.1	$290.0
28	CAMECO CORP.	28	▲4.6%	$307.2	$293.7
29	SHAW COMMUNICATIONS INC.^	N/A	▲0.7%	$296.0	$294.0
30	LA COOP FÉDÉRÉE	31	▲9.2%	$291.0	$266.6
31	KPMG LLP*	32	▲7.1%	$272.8	$254.8
32	HSBC BANK CANADA*	45	▲13.8%	$267.4	$235.0
33	TOROMONT INDUSTRIES LTD.	34	▲12.9%	$260.8	$231.0
34	APOTEX INC.	33	▲5.9%	$260.6	$246.1
35	HUSKY INJECTION MOLDING SYSTEMS LTD.	34	▲11.7%	$258.0	$231.0
36	PCL CONSTRUCTION GROUP INC.	36	▲7.9%	$243.4	$225.5
37	NIAGARA CASINOS	38	▲10.8%	$243.0	$219.4
38	GLENCORE CANADA	39	▲10.4%	$241.7	$219.0
39	TRANSALTA CORP.	37	▲6.2%	$238.7	$224.7
40	GEORGE WESTON LTD.	42	▲14.8%	$233.7	$203.6
41	CANADIAN BAPTIST MINISTRIES	40	▲6.1%	$230.2	$217.0
42	ENBRIDGE INC.[4]	116	▲3.1%	$226.2	$219.3
43	AVIVA CANADA INC. PENSION PLAN^	N/A	▲9.3%	$221.5	$202.6
44	ARCHDIOCESE OF VANCOUVER	43	▲8.0%	$216.0	$200.0
45	RESOLUTE FP CANADA INC.	47	▲9.8%	$201.0	$183.0
46	GOLDER ASSOCIATES LTD.	45	▲2.0%	$196.8	$193.0
47	ENCANA CORP.	44	▼-5.5%	$185.6	$196.5
48	BÂTIRENTE	50	▲11.1%	$181.7	$163.5
49	CITI CANADA	48	▼-3.2%	$173.7	$179.5
50	AON CANADA INC.	53	▲12.9%	$168.8	$149.5

Notes: * 2015 figure has been restated.
^ Both pension funds were not included last year. Shaw Communications declined to participate and Aviva Canada didn't complete the survey in time.
1. Following Sobeys' 2013 acquisition of Canada Safeway stores, $185 million in defined contribution assets were added to the Sobeys fund in 2016.
2. Cominico Pension Fund Co-ordinating Society, ranked No. 19 last year, was incorporated into Teck Resources Ltd.
3. Canadian Utilities Ltd. pension plan, ranked No. 23 last year, and ATCO Structures and Logistics have been consolidated as ATCO pension funds.
4. Enbridge acquired Spectra Energy in 2017. Consolidated figures for 2015 and 2016 account for the large movement in the year-over-year ranking.

Figures in this report are based on responses provided by the survey participants. *Benefits Canada* assumes no responsibility for the accuracy of the data provided. All totals are subject to +/- variance due to rounding.

POWERED BY Canadian Institutional Investment NETWORK

Source: Companies participating in the 2017 Canadian Institutional Investment Network pension fund survey or annual reports.

2016 Top 50 Total:	$36,425.2
2015 Top 50 Total:	$33,883.8
VARIANCE:	▲ 7.5%

Another trend is for employers to offer what he calls a stretch match to encourage employee savings. Williams describes a plan that recently went from a 100 per cent match to a design that encouraged even greater contributions by employees. The plan has a base employer contribution of three per cent and previously, if the employee contributed that amount as well, the company put in three per cent more for a total of nine per cent. Recently, the design changed so that if the employee contributes six per cent (on top of the three per cent base), the employer puts in an additional three per cent for a total of 12 per cent.

But higher contribution rates aren't necessarily a good idea for all plan members. As Williams points out, income levels are a key driver of contribution rates and government programs such as the Canada Pension Plan, old-age security and the guaranteed income supplement can be much more significant in retirement for those earning less. "If you are making $30,000 a year, you can ill afford to contribute since money goes to pay the bills, and CPP, OAS and GIS are going to provide a pretty good replacement rate. If lower-income individuals have more money, they may be better to put their savings in a [tax-free savings account]."

Michelle Loder, a partner in the defined contribution solutions business at Morneau Shepell Ltd., agrees that higher contributions aren't for everyone. "My first inclination is that we don't need to increase contributions," she says. "There is a general feeling that employees are not taking advantage of the match, so they leave money on the table. But if you only make $25,000, you don't have money to contribute. If you make $150,000 and up, you are more likely to contribute. My concern is there may be pressure to increase contributions without thinking of the context."

Any so-called magic number for contribution rates depends on a number of personal variables: current disposable income; expected lifestyle in retirement; health status; other sources of earnings; inflation; longevity; understanding of government benefits; whether someone is planning to work in retirement; and taxes and fees on investments today and in retirement.

"It's the employer's role to help people determine how much to save to get the retirement income they need," says Loder. "For example, eight per cent going into a plan is considered minimum, but that eight per cent may not be enough for someone making $150,000, while it could be too much for those making less than $40,000."

Holman agrees that contributions are an individual question. "As we move away from unproven, generic rules of thumb, such as the 70 per cent gross replacement rate, to focus on individual needs, plans with some form of base benefit that allow the employee to tailor the plan to meet their savings needs are gaining popularity," she says.

"They can also be more efficient and less costly for employers, as those with less savings needs won't be forced to save at a higher rate and attract the maximum matching. Yet those that need additional savings can achieve that with the sponsor's help."

Other levers available

All of that isn't to say that plan contributions shouldn't go up, at least for some members. "The balance someone accumulates on retirement is based on contributions and investment gains, minus withdrawals," says Hicks, adding that research shows raising contributions works well. "The challenge, however, is getting members engaged in the plan and escalating contribution rates over time."

DC PLAN ELIGIBILITY FOR EMPLOYERS WITH AT LEAST 500 EMPLOYEES

47%
Immediately

11%
3 months

3%
6 months

19%
12 months

4%
24 months

13%
Other

2%
No deadline

Source: Canadian Institutional Investment Network's 2016 CAP Benchmark Report

TOP 10 | HYBRID PLANS

2016 PENSION ASSETS (MILLIONS) ARE AS OF DEC. 31, 2016; 2015 PENSION ASSETS (MILLIONS) ARE AS OF DEC. 31, 2015

		2016 Pension Assets	2015 Pension Assets	Variance
1	Quebec Construction Industry*	$20,688.5	$19,401.4	▲ 6.6%
2	Suncor Energy Inc.	$4,271.5	$4,064.6	▲ 5.1%
3	York University	$2,316.8	$2,165.0	▲ 7.0%
4	ArcelorMittal Dofasco	$2,190.0	$2,048.9	▲ 6.9%
5	United Food and Commercial Workers Union pension plan	$2,122.4	$2,061.0	▲ 3.0%
6	Queen's University	$1,935.1	$1,800.0	▲ 7.5%
7	McGill University pension plan	$1,471.7	$1,444.9	▲ 1.9%
8	George Weston Ltd.	$1,335.3	$1,336.3	▼ -0.1%
9	University of Manitoba	$1,156.5	$1,099.4	▲ 5.2%
10	University of Victoria	$1,096.6	$1,046.8	▲ 4.8%
	Top 10 Total	**$38,584.4**	**$36,468.3**	**▲ 5.8%**

Note: * 2015 figure has been restated.
Source: Companies participating in the 2017 Canadian Institutional Investment Network's pension fund survey or annual reports.

The upcoming increase in CPP contributions could compound the difficulty of getting people to save more in their company plan. Although the aim of higher CPP contributions is to help provide better retirement incomes, the additional premiums will further reduce employees' net pay. For low-income workers, even going up a notch may be too much if their disposable income is barely enough to get by.

And even if employees want to contribute more, employers may balk at providing a match since it would push up the cost of funding the plan. "Increased company pension contributions could cause unintended consequences elsewhere in the total rewards framework, such as reductions to other benefit costs," says Loder. "And it might not achieve the optimal retirement outcome for members."

Instead of raising contribution levels, plan sponsors could be doing more to make sure employees get the information they need about appropriate contribution rates to meet their goals for retirement income, she adds. "Many more employers are upping the game in terms of what they offer members as part of retirement planning by expanding beyond traditional retirement education into debt management and financial literacy."

Plan design could also have a more positive impact on retirement outcomes by discouraging withdrawals and ensuring decumulation options are in place to support payout in retirement with the same services and fees, says Loder.

Making enrolment in the plan mandatory gets employees to join early and start saving for retirement. And automatic escalation of contributions, particularly when tied to a salary raise, can make it easier for employees to save more. "But that's driven more by the employer than the employee," says Williams. "And matches don't always increase."

Rather than automatic escalation, which tends to "raise all ships" when not all employees need to save the maximum amount, Holman stresses that the industry needs to do a better job of helping employees understand how much they need to save when they enrol in a plan and how that may change over time. "This is where it is crucial to provide customized support, to get people on the right path from the beginning," she says.

While raising contributions is one of the levers available to promote better retirement outcomes, employers can't do it blindly, says Loder. "The emphasis needs to switch to more dialogue about retirement income needs and how much to save to meet that expectation. Before raising contributions, you need to know why that strategy is necessary and what you are saving for. It's important to understand that higher rates aren't for everybody." BC

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