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Commentary: Increasing the efficiency of retirement savings

BY JIM KEOHANE AND ALEX MAZER · FEBRUARY 11, 2019 12:00 PM

Policymakers in both the U.S. and Canada are focused on how to strengthen retirement security for citizens. In the U.S., they are debating proposals to allow smaller employers to band together to offer retirement plans, as well as solutions to the funding crisis among multiemployer pension plans. In Canada, the federal government recently launched a consultation on strengthening retirement security, building on the enhancement to the Canada Pension Plan, which began in January.

In these debates, one issue deserves more attention: efficiency. In other words, how can we help savers get the maximum retirement income for every dollar of contribution?

The Healthcare of Ontario Pension Plan and Common Wealth recently released research on this question. While made in Canada, the research has relevance to retirement debates in the U.S. and around the world. Our research report, "The Value of a Good Pension," compares the efficiency of a variety of approaches to financing retirement, including a typical individual approach and four archetypes of workplace retirement plan. The report identifies five value drivers, present in the best collective retirement arrangements, that combine to drastically reduce the cost of retirement for individual savers:

- Mandatory or automatic savings.
- Lower fees and costs.
- Improved investment discipline.
- Fiduciary governance.
- Pooling of longevity and investment risk.

Based on evidence from the industry and academia, the report measures the cumulative effect of these five value drivers on the cost of retirement. The results are dramatic. Over a lifetime of work, it would cost a worker taking a typical individual approach nearly C$1 million more to achieve the same level of retirement income, compared to saving through a collective retirement plan with all five value drivers — a good pension. Put another way, for each dollar contributed, the retirement income from a good pension is C$5.32 — more than three times the C$1.70 that a typical individual approach yields.

While some of the report's analysis is specific to Canada, the five value drivers and their implications have global relevance. In fact, our conclusions were directionally consistent with a recent study by Wilson Sy, former senior researcher at the Australian Prudential Regulation Authority, comparing the efficiency of Australia's industry superannuation funds with that of its retail funds.

The five value drivers identified in the report are not theoretical. They are all present in many of the best-performing pension institutions in the world, including the "Canada model" of pension fund, of which HOOPP is an example. As highlighted in a recent World Bank report, Canada-model plans combine independent governance, in-house investment management, and extensive geographic and asset-class diversification, including direct investment in alternative asset classes. Canada-model plans, and the principles underlying them, could serve as guideposts for policymakers and other stakeholders looking to increase the efficiency of retirement savings, whether they are reforming existing plans or starting new ones.

The research shows the material value of being part of a workplace retirement plan, highlighting the need to expand access to these plans. While both Canada and the U.S. have seen a decline in workplace retirement plan coverage, efforts are underway in both countries to address this widening coverage gap. The report identifies a number of ideas for expanding access to collective retirement plans:

- Encouraging the establishment and testing of innovative, portable retirement benefits in the private and public sectors.
- Making the expansion of workplace retirement plan coverage an explicit goal of public policy and regulation.
- Allowing contingent workers, like freelancers and consultants, to join certain kinds of collective plans from which they are now excluded.

Beyond expanding coverage, the research suggests policymakers and employers should also focus on plan efficiency, using the five value drivers as a guide. Ideas for improving the efficiency of workplace retirement plans include:

- Encouraging automatic or mandatory contributions. The U.S. is ahead of Canada in its use of techniques such as automatic enrollment and automatic escalation, but these features could be more broadly adopted in both countries.
- Keeping costs low by promoting fee transparency, economies of scale and, for plans of a certain size, in-house investment management.
- Improving investment discipline by streamlining investment choices in workplace retirement plans and encouraging default investment options that are age-appropriate and well diversified.
- Improving fiduciary governance of plans by encouraging non-profit, independent governance structures that are mandated to put plan members' interests first.
- Encouraging greater availability of investment and longevity risk pooling vehicles in defined contribution plans. The need to provide greater support to DC plan members in the decumulation phase is a common preoccupation of stakeholders in many retirement systems.

In this era of stagnating wages and constrained household budgets, policymakers of all stripes are seeking ways to make life more affordable. More efficient retirement savings is one of the most important levers they have to do so. It's time that we placed efficiency at the center of our retirement policy conversations.

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