



Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

Frank Swedlove
President

March 16, 2009

Diane Lafleur
Financial Sector Policy Branch
Department of Finance
L'Esplanade Laurier
20th Floor, East Tower
140 O'Connor Street
Ottawa, Ontario
K1A 0G5

Dear Mme Lafleur:

**Strengthening the Legislative and Regulatory Framework for Private Pension Plans
Subject to the *Pension Benefits Standards Act, 1985***

I am writing on behalf of Canada's life and health insurance companies to congratulate the Government on undertaking the current review of the *Pension Benefits Standards Act, 1985* (the "*PBSA*") and to provide industry comments on specific issues of concern.

The Canadian Life and Health Insurance Association (CLHIA), established in 1894, is a voluntary trade association that represents the collective interests of its member life and health insurers. CLHIA member companies administer about two-thirds of Canada's pension plans and all or part of the employment-based retirement income arrangements for over 8.3 million Canadians.

This review and similar recent or on-going reviews of provincial pension regimes represent significant steps forward in promoting a thorough discussion and reform of the legislative and regulatory environment throughout Canada. But beyond modernizing, streamlining and harmonizing pension environments, CLHIA members hope that these measures will ultimately facilitate increased retirement income security for all Canadians.

Canada's life and health insurance companies support a comprehensive pension system and provide services to a full range of pension plans, with a primary focus on defined contribution (DC) pension plans. As a result, the comments in the attached document

1 Queen Street East
Suite 1700
Toronto, Ontario
M5C 2X9

Tel: (416) 777-2221
Fax: (416) 777-1895
www.clhia.ca

1, rue Queen Est
Bureau 1700
Toronto (Ontario)
M5C 2X9

Tél.: (416) 777-2221
Fax: (416) 777-1895
www.accap.ca



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centre on issues identified in the captioned Discussion Paper that have particular application to DC arrangements.

Representatives of CLHIA member companies will be participating in the consultations being conducted by your Minister's Parliamentary Assistant in conjunction with the release of this Discussion Paper, and the industry looks forward to expanding on the attached comments in our discussions with Mr. Menzies. We again congratulate the Government on this initiative, and encourage the Government of Canada, in cooperation with provincial authorities, to convene a comprehensive, national discussion including a wide representation of industry and consumer stakeholders, leading to a stronger and more cohesive system of retirement income security plans for all Canadians. In the interim, our industry stands ready to provide any further information or clarification regarding these issues.

Yours sincerely,

Original signed by

Frank Swedlove

Enclosure

cc. Mr. Ted Menzies
Mr. Tim Cleland



**Comments Regarding
“Strengthening the Legislative
and Regulatory Framework for
Private Pension Plans
Subject to the
Pension Benefits Standards Act, 1985”**

The Canadian Life and Health Insurance Association (CLHIA), established in 1894, is a voluntary trade association that represents the collective interests of its member life and health insurers. The Association's membership accounts for 99 per cent of the life and health insurance in force in Canada. CLHIA member companies are significant participants in the pension and retirement savings and income sector, administering about two-thirds of Canada's pension plans. The industry has a particular focus on defined contribution (DC) pensions and group registered retirement savings plans (RRSPs), as well as providing Canadians with complementary individual retirement savings and income products and services. In total, over 8.3 million Canadians have all or part of their employment-based retirement income arrangements managed by Canada's life and health insurance companies.

While the captioned Discussion Paper focuses on technical aspects of the existing legislative and regulatory environment in which pension plans exist, recent studies of the pension regimes in various provinces across Canada have started from the underlying objective of increasing the number of Canadians who participate in employment-based pension plans, thereby enhancing their expected retirement incomes. CLHIA members share that goal of expanding pension enrolment and income security among all Canadian workers and their families. The industry believes that the various pension reviews in Canada, both recently completed and in progress, will encourage and help inform an ongoing, comprehensive, national stakeholder discussion aimed at enhancing participation in efficient pension and retirement savings options by employers and individuals throughout Canada. CLHIA and its members will continue to be active participants in that dialogue.

Our comments below reflect not only operational effects, but are based on this broader policy objective. Given the industry's particular expertise in the realm of defined contribution pension plans, the following comments will focus on issues relevant to such plans. Before responding to the specific questions posed in the Discussion Paper, Canada's life and health insurance companies would like to review three central tenets upon which our recommendations are built.



Principles vs. Rules

Canada's life and health insurance companies endorse a more principles-based approach to pension legislation and supervision and an enhanced ability for regulators to focus supervisory efforts on plans at heightened risk of failure. International experience demonstrates that principles-based models, coupled with strong governance standards and risk-based supervision, are both efficient and prudent, and strongly suggests that more consistent and positive outcomes are attainable within a broad procedural framework relative to those arising from narrowly prescriptive processes. CLHIA members believe that principles-based legislative and risk-based regulatory approaches serve the public interest far more effectively, and can better facilitate rapid regulatory response to changing circumstances, than models that are purely rules-based. The Office of the Superintendent of Financial Institutions has made significant advances in adopting a risk-based regulatory approach, and remaining prescriptive rules should be re-evaluated in light of a more principles-based approach.

Prudence

The application of trust law to pension plans has raised ongoing confusion regarding the quasi-fiduciary standing of various stakeholders, as well as altering the perceived legal rights and entitlements of plan participants. The resulting litigation risk can be a significant concern for potential plan sponsors. In the context of contractually-based pensions, reasonable judgement and governance processes, good faith and due diligence should significantly limit such risk for plan sponsors. Canada's life and health insurance companies support the explicit construction of Canadian pension statutes as complete codes to significantly limit any intrusion of trust law concepts and to confirm that sponsors, Administrators and service providers of pension plans would be exposed to minimal litigation risk where they exercise reasonable pension judgement.

Harmonization

Canada's life and health insurers have a long standing commitment to harmonization of legislative and regulatory standards relating to pensions and other savings and income arrangements. Simplification and cost containment flowing from harmonization are central to encouraging employers to participate in what are otherwise potentially onerous employee benefit programs. Such harmonization also enhances the ease with which potential and existing plan participants may understand the benefits and obligations under their pension plans.

Harmonization is not a new idea. Since the 1920s, life and health insurers in Canada have operated under "uniform insurance acts" which are substantially similar in all



common law provinces and under the insurance portions of Quebec's *Civil Code*. And while evolving products and services may challenge standards written at too detailed a level, our industry's experience is that principles-based frameworks focusing on best practices can be highly effective and very robust, and are relatively easy to harmonize.

Canada's life and health insurance companies strongly endorse efforts to enhance harmonization of pension standards throughout Canada. The *Guidelines for Capital Accumulation Plans* (the "*CAP Guidelines*"), published in 2004 by the Joint Forum of Financial Market Regulators (the "Joint Forum") and developed in consultation with a wide range of stakeholders, including the CLHIA, apply to both DC pensions and other tax-assisted arrangements, and represent a significant step forward in the evolution of harmonized pension standards, without recourse to jurisdiction-specific regulations. In fact, structuring each jurisdiction's pension legislation to incorporate a principles-based framework specific to defined contribution pension plans, and coupling that framework to the *CAP Guidelines* through a regulatory reference or otherwise, could provide an easy route to a nationally harmonized DC pension regime. There are precedents for this approach; the regulation of individual variable insurance contracts (sometimes referred to as "segregated fund contracts") via linkage to an external standard already exists under Ontario's *Insurance Act*. Other jurisdictions have effectively adopted the same external standard without formal regulatory linkages.

Of course, the first step to harmonization is communication. *Getting Our Acts Together*, the recently completed report by the Joint Expert Panel on Pension Standards in Alberta and British Columbia, has proposed the formation of a national council of Ministers responsible for pension issues. This would be a potentially important advance in achieving greater consistency in pension legislation and regulation. In conjunction with efforts by the Canadian Association of Pension Supervisory Authorities ("CAPSA") and the proposed national council of Ministers, the industry joins other stakeholders in calling for a broadly-based, ongoing, national consultation on pension issues working toward full harmonization of pension standards and practices. As a first step, CLHIA members encourage that Ministerial forum to endorse the model pension law principles already developed by CAPSA. While agreement among regulators regarding these principles is important, political commitment to such harmonization is essential before substantive improvements and efficiencies in practice can be attained.

In light of this commitment to national harmonization, CLHIA members would have serious concerns if the Government of Canada were to choose to proceed in a manner that would create substantial differences between the legal and administrative frameworks for pensions at the federal level vis-à-vis other Canadian jurisdictions. While agreeing that leadership is needed, Canada's life and health insurance companies hope that significant consensus can be reached with respect to direction, substance and timing of changes prior to action being taken by various participants in those discussions.



Stimulating Pension Participation

Canada's life and health insurance companies have already noted our support for efforts to expand pension participation. However, if not done properly, some potential strategies to increase pension membership could require significant legislative and regulatory changes, and could have adverse economic impacts on employment. Such measures could also impose substantial logistical and cost challenges for governments, regulators and other stakeholders. For instance, imposing mandatory pension participation with required employer contributions would effectively increase payroll taxes, thereby discouraging both the creation of new jobs and the preservation of existing ones. Canada's life and health insurance companies believe that such measures would be unacceptable to government, employers and electors.

In contrast, recently completed provincial pension reviews have considered pension design issues to encourage participation in voluntary pension plans that might not be tied to specific employers and could enhance economies of scale. The industry supports this approach in general terms, and encourages all governments to enhance structures within the existing pension framework to facilitate further development of simplified, low-cost pension plan models to encourage expanded voluntary pension participation.

While CLHIA members support measures to voluntarily grow pension membership, the industry's extensive experience with employers considering retirement plan options for their employees suggests that failure to implement a pension plan is rarely if ever primarily driven by issues such as differential investment management and compliance costs between pensions and alternative plans. Rather, the decision to not establish a pension plan is frequently rooted in the employer's salary-based funding commitment. For small businesses in particular, cash flow and profitability can be unpredictable, making it difficult for an employer to commit to a long-term funding liability such as a pension plan. For these employers, group RRSPs are likely to remain the retirement savings vehicle of choice.

Similarly, many potential pension plan members have reservations about the cash flow requirements of participating in pension or retirement savings regimes. For individuals burdened with repayment of student debt, investing in a first home or saving for their children's education, these may be more immediate priorities and each of these alternatives can have significant long term economic value. Prudent financial management may justify deferral of retirement savings. It should not be assumed that pension participation is the right choice, at all times, for all Canadians.



Issues for Discussion Pertaining to Defined Contribution Plans

A. “Safe Harbour” Rules

As noted in the Discussion Paper, much of the historical commentary regarding safe harbour rules relates to default investment options. As with many product features, investment options evolve over time. Concern over the plan sponsors' liability re investment advice may have led to the use of default money market options where liquidity and capital preservation took priority over growth potential and inflation protection. While this may have been considered appropriate in earlier DC pension arrangements, this balance has shifted and such options have been largely replaced by asset allocation and "intelligent" target date funds. Increasingly, and particularly where a default investment option is in effect, current offerings are designed to continually monitor and modify an individual's investment mix based on that individual's anticipated retirement date, and any risk-profile completed by that individual. These offerings add professional investment option selection to the existing professional management of the underlying assets held in a particular fund, further protecting individuals from ill-informed investment choices.

More generally, defined contribution pensions have already incorporated a number of income security features and "consumer safety nets" that do not appear to have been considered in the Discussion Paper. The majority of DC plans provide individual members with investment discretion, but the continuing development of investment decision-making tools, guaranteed return investment options, reliance on automated asset allocation models and changes to default investment options that have a longer-term focus are some examples of how existing products already "de-risk" plans for individual participants. On the income side, products are currently offered that provide guaranteed lifetime income payments, with potential for increased income based on the performance of an underlying investment portfolio. In a very real sense, these products bridge the gap between traditional DC and RRSP products on one hand and traditional defined benefit products on the other, effectively improving on both the simple, historical, defined contribution pension plan and the target benefit model more common in multi-employer pension plans. Development of such “de-risking” products continues, and discussions of safe harbours should recognize not merely the choice of a default investment option but the extent to which a plan incorporates these broader issues as well.

The introduction of “safe harbour” rules for certain pension arrangements in the United States has suggested that compliance with stated regulatory standards would absolve plan sponsors and their agents from some forms of legal liability. It is unclear that such measures are actually having that effect. Proof of full compliance with detailed prescriptive requirements in order to take advantage of the safe harbour provisions is reportedly difficult, if not impossible, to verify. As proposed in Canada, it seems unlikely that litigation would disappear, but rather the basis of litigation might simply



shift from rules-based compliance to adherence with broader principles and governance standards. As well, a presumption that safe harbour rules would reflect “minimum standards” may not reflect their practical operation, since courts are more likely to reference best practices as an appropriate test to determine if a pension plan sponsor, Administrator or service provider has acted with appropriate diligence.

Suggestions for safe harbour provisions within Canadian pension jurisdictions have not generally led to adoption of such models. One possible approach is that taken in section 151.1 of Quebec’s *Supplemental Pension Plans Act* whereby a pension committee “is presumed to have acted with prudence where it acted in good faith on the basis of an expert’s opinion.” The admitted subjectivity of such a third-party opinion-based approach may make the reliability of such a test questionable. Moreover, the Quebec model attempts to provide pension committee members with a safe harbour by allowing a pension committee to delegate its fiduciary duties to service providers who may not have the same familiarity with the rationale behind a plan’s design or the detailed knowledge of the plan participants. Such a delegation creates a significant morale hazard on the part of pension committee members, and is questionable public policy.

In contrast to a legislated safe harbour based on a minimum standard, the Canadian regulatory approach, as exemplified by the Joint Forum's *CAP Guidelines*, and the parallel development of CAPSA’s *Governance Guideline and Self-Assessment Questionnaire* (the "*Governance Guideline*"), has been one of developing cultural compliance with voluntary best practices. In effect, compliance with these governance standards and operational processes may provide a *de facto* safe harbour, making a legislated safe harbour redundant.

Additional protections for sponsors and Administrators continue to evolve. Within the DC pensions context, some service providers are now offering to contractually indemnify plan sponsors with respect to the administration of such plans and certain educational and advisory services provided to plan members, thereby further mitigating any need for a legislative or regulatory safe harbour. These offerings clearly reflect market needs without regulatory mandating of such offerings, and expansion of such services should be expected as a natural development of plan design and sponsors’ internal governance objectives.

Since best practices evolve over time, the notion of what practices should qualify for a functional safe harbour - as opposed to a legislative safe harbour - is similarly likely to evolve. Canada’s life and health insurance companies support functional safe harbours where sponsors, Administrators and service providers act in accordance with contemporary best practices as reflected in the CAPSA *Governance Guideline* and the Joint Forum's *CAP Guidelines*, recognizing that those standards are themselves, subject to ongoing refinement.



With respect to the specific types of investment options that might be appropriate as default options, these will vary but should always reflect the same prudent expertise that the plan sponsor and any service providers should bring to bear on the selection of the set of investment options offered under the arrangement and any investment selection tools offered to plan participants. As with investment rules generally, more prescriptive definition of acceptable default investment options is inappropriate and inconsistent with a prudent, principles-based, legislative framework.

B. Variable Benefits

Historically, pension plan members had little if any ability to alter income payments following retirement. An annuity option would be chosen and locked in, with the only choices being the percentage of the benefits payable to the retired individual that would continue to be paid to a surviving spouse after the death of the plan participant, and possibly some assumed indexation as a hedge against future inflation. Similar limited options were available to those saving for retirement via Registered Retirement Savings Plans.

The introduction of Registered Retirement Income Funds (RRIFs), whereby RRSP annuitants could continue to manage the investment options held following maturity of their RRSPs after age 71, also provided those annuitants with some limited control over the quantum of each year's income payments out of the RRIF. Required minimum annual withdrawals apply to all RRIFs, and where a RRIF is created using funds transferred from a pension plan, maximum withdrawal limits also apply. The resultant plan is typically referred to as a Life Income Fund, or LIF.

While the provision of RRIF-like variable benefits from within a pension plan appears to be reasonable in theory, the frequency of requests for such benefits in jurisdictions that permit them is relatively low. This may reflect their relatively recent introduction, but may also flow from the ambivalence of some plan sponsors to providing such benefits, since they complicate and increase the cost of plan compliance.

It would appear likely that demand for such benefits would be limited, even if such benefits were a statutorily required option within federally registered pension plans. Indeed, recent economic events have underlined the value of guaranteed annual income products, and appear to be driving a trend away from variable benefit selections. This trend predates the events of 2007 and 2008.

In addition to increasing the plan sponsor's administrative costs, spreading the administrative and compliance costs of offering variable benefits from within a pension plan across all pension participants could unreasonably reduce the value of the plan benefits for those participants who choose not to avail themselves of such benefits. Since



the individuals using such benefits are, by definition, no longer actively at work for that sponsor, many sponsors view such increased costs as being inappropriate. Conversely, an argument might be made that retaining the assets supporting variable benefits within a pension plan reduces the relative level of management expenses, by spreading those costs over a larger asset value.

On balance, Canada's life and health insurance companies believe that there is undue complexity and cost associated with the provision of variable benefits from within pension plans, but believe that there may be alternative structures, including existing "group LIFs", where costs could be more appropriately pooled among individuals seeking RRIF-like benefits. Where such benefits are sought, the industry recommends that benefit entitlements be transferred to separate arrangements, possibly administered by the same service providers but without any cost obligations falling to the sponsors or other plan participants of the pension plans from which those amounts are transferred. Since the receiving arrangements would similarly take advantage of pooling strategies to optimize investment choices while minimizing costs, there seems to be little benefit that would arise from retaining those amounts and administering variable benefits from within the originating pension plans.

C. Sponsors' and Administrators' Standard of Care

The industry has noted on several occasions above the role of both the CAPSA *Governance Guideline* and the Joint Forum's *CAP Guidelines*, and the belief that, in conjunction with prudent pension judgement and reliance on the expertise of appropriate service providers, these standards represent an effective basis for the design, operation and supervision of DC pension plans that offer individual participants choice with respect to investment options. The industry has further noted that the fundamentals underlying these standards, and the practical application of the relevant portions of these standards, are reasonably applicable to DC plans that do not offer investment choice, and to non-pension arrangements.

Where a pension plan sponsor and Administrator adhere to such standards, Canada's life and health insurance companies believe that a functional safe harbour should exist with respect to claims by pension plan participants, and that prudent judgement and good faith should be an acceptable and effective defence against such claims. Explicit reference to these standards in federal pension regulations, and endorsement of such a good faith standard in federal pension legislation is, in the view of CLHIA members, entirely reasonable and appropriate. A standard of care based on an assumed fiduciary relationship between the sponsor and/or Administrator and plan participants is inappropriate given the character and design of DC pension plans. A good faith standard reflective of their particular expertise should also be applicable to any service providers retained by the sponsor or Administrator in respect of the operation of the plan.



D. Use of Surplus in Hybrid Plans

The Discussion Paper indicates that “generally, sponsors are able to use surplus to fund their defined benefit current service costs.” The influence of trust law on pension arrangements, and the resultant claims by plan participants to surplus amounts on plan termination, either in whole or in part, may bring this statement into question, along with the more general use of surplus by the plan sponsor.

To the extent that plan surplus is used to fund defined benefit current service costs, that use of plan surplus is arguably for the benefit of plan participants. But where a pension plan offers both defined benefit and defined contribution elements, there may be scenarios in which the participants in one element of the plan will not participate in the other component. Consequently, the use of plan surplus to fund employer contributions with respect to the defined contribution element of the plan may not benefit those plan members who only have defined benefit entitlements under the plan, and that use may be subject to challenge.

While Canada’s life and health insurance companies support the ability of plan sponsors to fund defined contribution pensions using defined benefit plan surplus where both benefit types are provided within a single pension plan, this issue may be most appropriately addressed within the broader context of the sponsors’ and other plan participants’ rights vis-à-vis plan surplus. Statutory recognition of pension legislation as complete codes, independent of the application of trust law, would provide much needed clarification and certainty in this frequently litigious area.

E. Administrative Streamlining

Asset Transfers for “Stranded” Benefits

The Discussion Paper notes the administrative difficulties relating to the treatment of benefit entitlements for individuals who have terminated employment prior to being eligible for the payment of pension benefits, and where those individuals do not direct the Administrator to transfer their entitlements to another pension plan, or to another retirement savings and/or income arrangement. The effect is to require the sponsor to incur ongoing costs to administer those “stranded” benefits. CLHIA members support the automatic transfer of benefits for terminated plan participants to arrangements that would not expose pension sponsors and Administrators to continuing cost.

Both *A Fine Balance*, the Report of Ontario's Expert Commission on Pensions, and *Promises to Keep*, the Report of Nova Scotia's Pension Review Panel, have suggested the creation of a government agency to receive and administer such benefits, although it is



unclear that such transfers of assets would be automatic. This proposal would effectively duplicate and inappropriately compete with existing options, be they structured as locked-in retirement accounts, life income funds or annuity purchase options.

The "stranding" of pension entitlements is largely a result of disruptions in the flow of information between employers, individuals and service providers. Increasing labour mobility, resulting in comparatively small pension benefit entitlements being scattered amongst multiple plans, compounds this challenge, and aggregation of those amounts by service providers could significantly streamline benefit administration and payments. While individuals may not realize they have benefit entitlements, pension Administrators and record keepers will always have that information. It is the difficulty that Administrators and record keepers have in accessing current information regarding individuals that interferes with the consolidating these small entitlements and payment of stranded pension benefits. Rather than creating a parallel, asset management structure, all governments should ease pension Administrators' access to information that would facilitate their obtaining instructions in order to fulfill benefit payments. Where assets sourced in pension plans have been transferred to successor products, similar access to consumer information is crucial to delivery of the promised benefits.

The Discussion Paper notes that such transfers would only be possible with appropriate notice to the (former) plan participant. Absent significant expansion of Administrators' ability to locate such individuals, no material improvement in the treatment of stranded benefit entitlements will arise unless such asset transfers are permitted as a contractual default mechanism.

It has been suggested that forced transfers of benefit entitlements create excessive costs for individuals. The industry disputes such claims. As indicated above, existing arrangements for administration of locked-in amounts already benefit from pooling in terms of the administrative and investment management costs, as well as the obvious pooling aspects of mortality. Moreover, vigorous competition means that individuals have the security and protection that comes from product and investment diversification amongst a multitude of suppliers, all of which are regulated financial institutions.

It has also been suggested that, where benefit entitlements are used to purchase annuities, existing annuity options restrict investment choice by former plan members, and limit flexibility. With reference to the Ontario and Nova Scotia proposals, it is unclear how the proposed government agencies would offer investment choice while still providing the cost benefits of investment pooling. Similarly, allegations that annuities are too expensive or that there is inadequate capacity for such offerings may reflect a poor understanding of the price - and value - of the fully guaranteed income provided by an annuity, as opposed to the potentially diminished income provided by a fund that is tied to a fluctuating asset value.



The annuity market in Canada is large and vibrant. This is evidenced by the competing bids that have been tendered when large pension plan wind-ups requiring annuitization have been taken to market, in tranches or otherwise.

Locking In

Canada's life and health insurance companies acknowledge that there are a range of strongly held views on whether former pension plan participants who are no longer actively at work for the purposes of a given pension plan should have access to the assets held within that plan or a successor financial instrument for purposes other than the provision of retirement income. In effect, debate centres on the nature of the "pension promise", and whether (former) members have - or should have - capital interests in a pension plan, in addition to income interests. In recent years, the legislative and regulatory response in many jurisdictions has been to broaden access to such funds to provide limited access to capital interests prior to retirement age.

While interpreting the pension promise to include a capital interest may be popular with plan members, it is generally considered to be contrary to the traditional view of pension policy makers and plan sponsors. Indeed, one of the oft-heard rationales for the "superiority" of pensions over non-pension savings and income products such as RRSPs is the reduced liquidity and dedicated retirement income purpose of pension plans. Given increasing labour mobility and the consequential increased likelihood of individuals drawing on pension capital if it is available, it is unclear that pension plans can continue to lay claim to such superiority over alternative arrangements.

Retired and other former pension plan members may demand access to plan capital, but it is unclear how providing access to accumulated pension entitlements as a lump sum is consistent with the promotion of pension participation as a means of securing retirement income. A secure future pension may be of questionable value to those in financial crisis today, and mechanisms exist in multiple jurisdictions to permit unlocking of pension entitlements due to reduced life expectancy, financial hardship, for very small balances and where an individual becomes non-resident. These triggers are generally conceded as being justifiable and not inconsistent with the objective of pension policy.

Providing early access to RRIF-style benefits during periods of temporary unemployment or particular hardship may be worthy of consideration. More generally, broader issues of access to plan capital may benefit from further discussion at the national level, particularly since individual pension jurisdictions have adopted a range of policies to facilitate greater or lesser degrees of access.



Reporting to Non-Participants

Under the current federal pension regime, spouses and common-law partners of plan participants are entitled to receive copies of documents provided to plan participants. These documents include annual statements of benefits, quotations of benefits on termination of employment and upon retirement, as well as general information describing the plan. Parallel requirements do not apply under provincial pension legislation.

While ensuring that spouses and common-law partners are well informed regarding their partner's pension entitlements is understandable, pension participants tend to be less than diligent in communicating changes in their marital status to pension Administrators. Such failures may not pose particular problems upon marriage or entry into a common-law relationship, but where a marriage or common-law relationship ceases, there is a significant risk that continued provision of pension information to a former spouse or common-law partner could breach the plan participant's privacy rights. Given the consequential litigation risks, CLHIA members believe that a review of the appropriateness of such disclosures may be warranted, particularly in light of harmonization efforts relative to provincial pension standards. It may be more appropriate to focus disclosure to spouses and common-law partners on events giving rise to specific rights at the time those rights crystallize, as with survivor rights upon a plan participant's death.

Funding Documentation

One of the more significant ongoing challenges for pension Administrators and service providers is the documentation of expected contributions by the sponsor and Administrator and the matching of these amounts to the actual contributions received by the service provider. Discrepancies between expected and actual cash flows can be an early indicator of increased risk within a pension plan, and such documentation is required by various pension regulators across Canada.

Recent discussions between CLHIA members and officials of the Office of the Superintendent of Financial Institutions have highlighted the need for enhanced communication of OSFI's expectations in this regard to plan Administrators, and greater harmonization of administrative and reporting standards with other jurisdictions. CLHIA members will continue to work with OSFI and other CAPSA member authorities to improve administrative efficiencies and enhance information flow in order to most effectively apply regulators' risk assessment methods.



Other Issues Respecting the Framework for Private Pension Plans

A. Flexibility and Alternative Plan Designs

Recent provincial pension reports have focused on the development of a variety of plans, in particular "specified contribution target benefit" pension plans. These are often characterized as defined benefit plans where the benefits payable are subject to downward adjustment if underlying assets are inadequate to deliver the intended income levels. Such target benefit plans might equally be described as defined contribution plans under which investment strategy and the consequential investment performance and retirement incomes are pooled under professional management.

While primarily discussed in the context of "jointly governed" target benefit plans that may have application in a collective bargaining context, joint governance is not generally practical in increasingly common non-unionized contexts. To provide more widely available plans and avoid the complexity of target benefit plans as contemplated in the provincial reports, the recent provincial pension reviews have suggested that a defined contribution plan could be offered more generally as a publicly organized plan and made available to employers and individuals who might not otherwise be willing or able to bear the costs and compliance burdens of a traditional single employer pension plan.

Canada's life and health insurance companies believe that the DC challenge is not one of developing appropriate and accountable retirement income products - those already exist and are constantly being enhanced. Rather, the challenge is one of legislative and regulatory limits that may interfere with the most efficient offering of such products to the pension market. Clarifying that regulated financial institutions can offer "off the shelf" participation in pension arrangements to unrelated employers, or directly to individuals, would remove much of the compliance burden from the shoulders of employers, further enhance the administrative economies of scale within pension plans and expand access to such plans, since individual participation might not be contingent on employer participation. Such measures could allow low costs to be driven even lower, and would broaden the appeal and availability of simple pension plans to a point where they would become more competitive with non-pension arrangements such as group RRSPs.

To facilitate these advances, the industry suggests two specific initiatives:

1. Ensuring enrolment of new employees within employment benefit programs can be problematic. Auto-enrolment, auto-escalation of contributions and other evolving product design features significantly enhance the efficacy of pension plans. A statutory mechanism to facilitate mandatory pension enrolment with ability for the employee to "opt out" could be incorporated into sections 14 and 15 of the *PBSA*.



2. Similarly, an employee's pension contributions are frequently frozen based on historical amounts because the *Canada Labour Code* and provincial employment standards legislation generally prevent modification of deductions from salary without the employee's explicit consent. Amendment of section 254.1 of the *Canada Labour Code* and parallel provisions of applicable provincial statutes to facilitate an employer's adjustment of pension contribution deductions in response to increased salary or seniority would significantly enhance the effectiveness of existing pension regimes.

In light of these evolving products and simple changes to the legislative framework, it is unclear that there is a compelling case to be made for the creation of a government-operated pension plan for private sector employers and employees. When development and operating expenses of such an initiative are considered, it seems unlikely that a public regime would operate on a cost-competitive basis relative to existing private sector offerings. And to the extent that any portion of those costs might be borne by taxpayers who do not participate in the plan, this would appear to represent an unreasonable competitive position vis-à-vis privately offered plans, particularly as other governments act to support domestic industries as a result of the ongoing credit crisis.

B. & C. Multi-Employer Pension Plans and Simplified Pension Plans

As currently implemented, the legislative framework for multi-employer pension plans poses some significant difficulties, particularly where plans involve multiple jurisdictions. Better definition of any required nexus of employment, harmonization of administrative requirements, clarification of the responsibilities and liabilities of various stakeholders and addressing voluntary versus mandatory participation are routinely identified as complications of such arrangements.

Industry experience with Simplified Pension Plans as they are currently required to be structured suggests that such arrangements hold little appeal to pension plan sponsors, Administrators and service providers. Quebec's Simplified Pension Plan regime transfers significant legal liabilities from the Pension Committee to service providers, but provides those service providers with limited means to assess member needs or otherwise fulfill those obligations. Statutory availability of such plans might reasonably be maintained, but it is likely that such arrangements would ultimately be subsumed in more broadly-based plans as described below.

As discussed under "Safe Harbour" Rules and "Flexibility and Alternative Plan Designs" earlier in this document, the evolution of DC pension plans and the ability of regulated financial institutions to act as sponsors and Administrators of broadly-offered pension plans with no employment connection between plan participants would effectively extend the model of large scale multi-employer pension plans to the entire population of



employed and self-employed individuals who do not currently participate in employment-based pension arrangements. The various “de-risking” mechanisms previously discussed further enhance the decision making process and security of benefits for plan participants beyond those typically offered in current multi-employer pension plans.

CLHIA members strongly endorse the legislative and regulatory changes necessary to facilitate the offering of such broadly-based plans as a significant means of expanding the availability of pension participation amongst individuals, even where employers do not participate in such offerings.

D. Segregation of DB and DC Legislative Provisions

While the division of pension statutes into parallel parts to address defined benefit pensions separately from defined contribution plans appears to have merit, the evolution of hybrid plans may make such legislative bifurcation impractical. However, adoption of a principles-based legislative framework, and acknowledgement within integrated regulations of the non-applicability of particular regulatory provisions to plans providing only alternative types of benefits would significantly clarify pension administration and compliance, and should form part of the object of any statutory revision.

E. Investment Rules

The broad pension investment management industry has expressed concern and frustration with the structure of the investment rules for many years. In August 2001, the Pension Investment Regulations Task Force, comprised of representatives of the Association of Canadian Pension Management (ACPM), the Pension Investment Association of Canada (PIAC), the Investment Counsel Association of Canada (ICAC) and CLHIA, submitted *Recommendations for Modifications to Pension Plan Investment Rules* to the CAPSA Investment Policy Committee. Two years later, additional industry responses to a consultation paper on the ten per cent concentration rule were provided to CAPSA. In each case, strong industry consensus existed to adopt a purely prudential investment regime. In addition, during the development of the Joint Forum’s *CAP Guidelines* in 2003, a fundamental logical flaw in the investment rules as they apply to defined contribution plans was repeatedly noted. In response to those comments, the Joint Forum recruited industry participants, including representatives of CLHIA, ACPM, PIAC, ICAC, the Investment Funds Institute of Canada and the Ontario Bar Association to detail the challenges of the existing investment rules.

The investment rules contained in Schedule III of the *PBSA* are, like many aspects of the Act, designed from the perspective of defined benefit pension plans and do not function appropriately in the context of defined contribution arrangements where individual plan



participants have investment choice. In particular, the rules apply at the level of the plan, rather than at the level of each individual participant. Thus, while the rules are designed to ensure diversification and liquidity, any particular individual can invest in a highly concentrated and potentially illiquid manner, as long as the plan as a whole satisfies the rules of the Schedule.

In order to avoid this clearly unintended result, service providers to DC plans typically ensure that each investment option offered within the plan would satisfy the diversification and liquidity standards of the Schedule. But this too, can have unexpected effects.

Most of the investment options offered for DC pension plans are investment funds that are also available to retail investors, although the fee structures associated with pension plans are typically reduced relative to retail products. Because the funds are used for pension and non-pension purposes, both the investment rules applicable to retail, non-pension, products and those contained in Schedule III apply simultaneously. In particular, for mutual funds, the relevant investment limitations are set out in the Canadian Securities Administrators' *National Instrument (NI) 81-102: Mutual Funds*. For insurance-based products, the CLHIA, in conjunction with the Canadian Council of Insurance Regulators, has developed separate investment rules, which are contained in *Guideline G2 – Individual Variable Insurance Contracts Relating to Segregated Funds (the “IVIC Guideline”)*.

While the general intent of the Schedule III investment rules closely parallels those of NI 81-102 and the *IVIC Guideline*, there are comparatively minor differences. Some of the rules use the original purchase price of the underlying assets for comparison purposes, while others use the current market price. Some test only at time of purchase, while others test on an ongoing basis. Some limit real estate investments and/or holdings of resource properties, while others do not. Some regimes permit the lending of securities, while others don't. Some require the investor to “look through” underlying conglomerates to find the total holdings, including indirect holdings, in each individual entity, while others stop such “drill downs” at the top most holding.

There is no hierarchy or deference between the various investment rules. Thus, simultaneous application of two – and sometimes all three regimes – is common. This creates expensive – and sometimes contradictory - redundancies.

While such quantitative testing may provide pension, securities and insurance regulators with confidence, these limits are, in large part, irrelevant. One obvious test illustrates this point. All of these rules maintain a ten per cent maximum for the holdings of any one corporate entity. Yet in practice, investment managers would consider any investment approaching even half that amount to represent unreasonable concentration, unless the fund was specifically structured to track an index where there was disproportionate



weighting of particular securities, as was the case with the Toronto Stock Exchange Composite Index and Nortel over the last ten years. Arguably, reliance on quantitative concentration limits failed to protect pension plan participants and other investors from the subsequent fall in value of Nortel.

Concurrent compliance with multiple investment rules significantly increases operating costs that are ultimately borne by consumers and pension participants. But attempting to avoid overlapping or contradictory rules is sub-optimal as well. Dedicated funds can be designed to comply with only pension rules, but the smaller asset value of such funds means that their operating costs tend to be higher than for funds that can be pooled with retail products.

The preference of the industry working group formed by the Joint Forum in 2004 was for the adoption of a prudential standard applicable to all such regimes. Given the then prevailing attitudes of regulators, this recommendation was not accepted. As a near term alternative, the industry working group recommended a deference standard, where the rules applicable to an underlying investment fund would be accepted in lieu of any rules applicable to another structure that invested in the underlying structure. For example, if a pension plan invested in a life insurance company's segregated fund that was in turn invested in a mutual fund, the investment rules contained in NI 81-102 would be accepted for the purposes of both the *IVIC Guideline* and Schedule III.

Precedent exists for this approach, since Schedule III already provides a deference rule for the investments held by life insurance companies that underlie annuities held with respect to pension plans.

Although neither the prudential nor deferential approach were accepted by the Joint Forum, the recently completed review of Alberta's and British Columbia's pension regimes has recommended a new prudentially-based investment regime.

Canada's life and health insurance companies have expressed concern to other jurisdictions where reform of investment rules would result in de-linkage from Schedule III. The industry is concerned that, should other jurisdictions adopt alternative quantitative investment rules, such measures may lead to reduced consistency in investment standards between Canadian pension jurisdictions, which may significantly increase compliance costs that are ultimately borne by plan participants.

CLHIA members have encouraged those jurisdictions to consult with Ministers responsible for pensions in other Canadian jurisdictions in an effort to coordinate simultaneous adoption of parallel, and ideally identical, prudentially-based, investment rules for all pension plans.



CLHIA members strongly encourage the Government to take a leadership role in replacing the existing prescriptive, quantitative investment rules and adopting a purely prudential standard for pension plans, as already applies for investments by federally regulated life and health insurance companies. The standards should reflect prudence and expertise, strengthening the existing "prudent lay person" standard that has historically overlain quantitative limits. This measure should also support pension Administrators' reliance on professional investment management, and enable Administrators to more appropriately focus their attention on governance and oversight. Such reform would represent a significant streamlining of investment rules relative to the current rules, and eliminate conflict with investment diversification and liquidity standards for other investment vehicles such as mutual funds and segregated funds. This would represent a highly significant first step toward rationalizing a dysfunctional web of contradictory, redundant and largely irrelevant investment rules not only for federally regulated pension plans, but for a wider range of financial instruments throughout Canada.

Conclusions

Understanding of, participation in and administration of employment pensions can be enhanced. But Canada's employment pension system and the broader retirement income system, including RRSPs, is not fundamentally broken. When RRSPs are considered, there is a significantly larger number of Canadians savings for retirement than when pensions alone are considered. Unfortunately, each of the recently completed pension reviews has taken a less contextual view of retirement arrangements, and has suggested a lower level of retirement preparedness than is actually the case. Many Canadians are, however, uncertain regarding the adequacy of their retirement savings, regardless of their form.

The challenge of increasing retirement savings in general, and of expanding pension participation in particular, is one of environment, degree and fine-tuning, not a fundamental lack of appropriate products and options. Harmonization of legislative and regulatory models, eliminating inappropriate applications of trust law and streamlining compliance processes can help minimize risks that discourage sponsors from offering pension plans, and minor legislative changes to automate participation by individuals can significantly simplify pensions for a wide range of employers and consumers.

Pensions in Canada started as annuities. Canada's life and health insurance companies are expert in the provision of these evolving arrangements, both as assets are accumulated during an individual's working lifetime, and as guaranteed incomes are paid out. The industry is firmly committed to continuing to provide millions of Canadians with affordable, flexible, safe and secure retirement incomes through this robust vehicle.