Public Submission to

Nova Scotia Pension Review Panel

By

CARP, Canada's Association for the Fifty Plus

CARP submission to the Nova Scotia Pension Review Panel

Introduction

CARP is a national, non-partisan, non-profit organization with 350,000 members across the country. CARP is committed to advocating for social change that will enhance quality of life for all Canadians as we age. One of our advocacy goals is financial and retirement security.

The Canadian pension system is generally thought of as a multi-pillared system designed to support older adults in maintaining pre-retirement living standards after they have retired.

The first is generally thought of as the universal/state operated plan, the Guaranteed Income Supplement (GIS) and the Old Age Security (OAS) benefits are funded through tax revenues.

The second consists of the Canada Pension Plan and the Quebec Pension Plan (CPP/QPP). This pension is a very large work-based plan available to all workers. Deductions are made from payroll and unless one is self-employed, contributions are divided equally between employer and employee.

The third pillar encompasses all private savings. These can be private Retirement Registered Savings Plans (RRSPs), group RRSPs, Defined-Benefit (DB), Defined-Contribution (DC) or Hybrid plans. Generally, DB plans have been preferred by employees because they guarantee regular benefits based on salary and years of service but many employers feel that the plans are costly and risky.

Given the ageing of the population, pension plan legislation and participation has become a very serious issue. A recent C.D. Howe institute study revealed that an estimated 3.5 million Canadian workers are not members of a workplace pension plan and that they are not saving at a rate sufficient to help them maintain their standard of living into retirement. The study also concluded that 5.5 million Canadians currently have their savings invested in retail products with high sales and management costs that are severely hindering their ability to save adequately for retirement. Even the savvy boomers are not insulated from this phenomenon; a 2006 Globe&Mail/Strategic Council poll revealed that only 28% of them were very confident they would be financially secure in their old age. Evidence is mounting and indicates that we need to review our pension system, our long-term goals and promote increased retirement security and financial literacy.

The objectives of pension legislation

The main goal of pension legislation should be to ensure retirement security. The objectives articulated by the Panel to help guide their review of the *Pension Benefits Act* are all appropriate given that they all strive to uphold the integrity and transparency of pension plans. These elements are also of the utmost importance in ensuring retirement security for pensioners and we would urge the Panel to adopt the most stringent standards in establishing whether or not certain practices contribute or detract from these goals. A worthwhile challenge might be to consider how legislation could be amended in order to be more pro-active in encouraging objectives such as increased retirement savings and economic stability. Canadians with mid-level income working for smaller firms tend to be left out of the formal pension system. Changes in pension regulation should make sponsoring a plan more attractive to small firms. In the long-run, the best way to meet the increased demand for pensions without decreasing current workers' standards of living will be to increase labour productivity.

Recommendations:

- The main criteria by which to review the *Pension Benefits Act* should be whether it promotes retirement security followed by integrity and transparency.
- The Panel should consider whether legislation might be amended in order to be more pro-active in encouraging objectives such as increased retirement savings and economic stability.

Defined Benefit and Defined Contribution Plans

In many respects, Defined Benefit plans are preferable to Defined Contribution plans because they guarantee set benefits. Any risks due to market volatility or actuarial error are borne by the employer on the premise that it is better able to absorb it. In recent years, there has been a trend of converting DB plans to DC plans because employers considered DB plans too risky and costly. However, a recent Watson Wyatt/Conference Board of Canada Pension Risk Survey indicates that this trend is relaxing: the rate of respondents converting from DB to DC plans decreased from 9% in the last 24 months to 3% in the last twelve. According to David Burke, Watson Wyatt's Canadian Retirement Practice Director:

> "The increasing influence of the HR function will allow respondents to use plan design to address the issue of attracting and retaining highly-skilled or high-performing employees… Respondents continue to view DB plans as superior to other retirement savings arrangements for employee retention, which may be due partly to the concerns they have expressed about the ability of DC plans to provide adequate retirement income for plan members."[1]

There may be a market-based argument for employers' use of DB plans; as previously mentioned in our submission In the end, long-term and sustainable economic growth comes from increased labour productivity. If the public can be educated in regards to the merit and worth of DB benefits then an increasing share of employers will have to offer them in order to attract skilled workers. The survey also indicated that CFOs were increasingly beginning to see pension crisis as being cyclical rather than a long-term problem, that they did not intend to change their investment strategies and that they were calling for less stringent minimum deficit funding requirements.

Making DB plans more attractive to employers by reducing funding risks is certainly an option worth considering but we would recommend the panel proceed with caution on this issue and remain mindful that the primary goal of legislative reform should be retirement security. We also encourage the idea of considering new DB and Hybrid pension models in order to enhance their availability: there is always the possibility that companies may be innovative and fresh in their approach. Ideally the Review Panel might make recommendations that would allow for some experimentation to occur within the confines of prudence.

Given the imminent labour-shortage and knowledge gap as highly experienced and skilled labourers leave the workforce, CARP advocates for increased incentives to keep older workers working longer. Incentives can include increased portability or flexibility of pension plans, attractive part-time work schedules, continued pension plan participation etc. In this respect, one of the advantages of DC pensions may be their portability. However, the Panel notes that some of these plans might not be advantageous to recipients given that they sometimes require the employee to convert the funds as of their retirement date. As explained, this can negatively influence the value of the plan if circumstances, such as the interest rate, prove unfavourable.

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[1] "Concerns Diminishing About Pension Risks as Long-Term Crisis", http://www.conferenceboard.ca/press/2008/pension-risk.asp, Consulted July 13th 2008

CARP recommends that plans be obligated to remove such stipulations which discriminate against older workers who are capable and wish to keep working. We also recommend that the Panel consider options in addition to members being able roll their assets into a Life Income Fund (LIF). We will elaborate on LIFs later in this submission but suffice it to say that many older adults do not consider them a preferred retirement savings vehicle. If the funds need to be converted when the employee leaves the company, they should be given a reasonable timeframe within which they may chose to purchase an RRSP.

Recommendations:

- CARP recommends that the panel consider reducing funding risks to make DB plans more attractive to employers. It is also a good idea that the Panel examine the effect of new hybrid plan models. While considering these options, the Panel should bear in mind that retirement security remains the central goal of this investigation.
- We recommend that any stipulation obligating DC plan members to roll their pensions into a LIF as of their retirement date be removed. If the funds need to be converted when the member retires, they should be given a reasonable timeframe within which they may chose to purchase an RRSP or a LIF.

Surpluses

The surpluses that can occur in defined benefit plans present a host of extremely contentious issues. On one hand, the concept of "deferred wages" is entirely valid. Both wages and pensions are part of a package designed to attract and retain labour. Employees agree that the employer put aside a certain amount of money and administer it on their behalf. It can be argued that employees are entitled to the surplus because it is an investment of their wages. On the other hand, employers need to maintain the security of their DB plans. A surplus can be succeeded by a deficit the following year; everyone accepts that markets are cyclical. It can be argued that managers need to retain surpluses to insure the continued solvency of their funding.

The issue of surpluses engenders several complications. This has recently been made obvious by the Ontario Court of Appeal's ruling in *Kerry (Canada) Inc. v. DCA Employees Pension Committee.* The decision has been appealed to the Supreme Court of Canada and that court should pronounce on the use of surplus in the context of financing contribution holidays where a DB plan has been converted to a DC plan but may or may not settle the question of to whom the surplus belongs.

The court's ruling raised some other very pertinent issues, such as which expenses may be charged to the fund and communication with plan members. Although the ruling upheld the cross-subsidization of the DB and DC plans, it was highly critical of the employer's communications with employees in regards to plan conversion. Clearly transparency, honesty and plain language are essential when communicating with people whose financial assets are being administered by others. In regards to clarity issue in communications, CARP would support the Court of Appeal's ruling.

Recommendations:

- We concur with the Court of Appeal's condemnation of employer-employee communications in the Kerry case. We urge to Panel to consider legislation that would impose on plan sponsors a stricter standard of transparency and clarity when alerting plan members to any changes in plan structure.
- While recognizing that both employers and employees have strong arguments for ownership of DB plan surpluses, CARP's primary focus is on retirement security and on balance, would recommend that pension legislation be strengthened to protect against the erosion of retirement security resulting from contribution holidays, inappropriate allocation of expenses to outright encroachment or appropriation of pension surpluses.

The Canada Supplementary Pension Plan: Something to Consider

In order to maintain an adequate standard of living through retirement, it is generally argued that individuals will need 70% of their pre-retirement income. This percentage may vary according to pre-retirement income, where we live and individual needs. In most cases, private savings will be required to supplement OAS/GIS and CPP to ensure that this standard is met. We know that many Canadians are not saving nearly enough for retirement: only 71% of Canadian households have private pension savings and of these 9.4 million, it appears only 47% (4.4 million) are saving enough to meet the standard.[2] Because this indicates that new ways of encouraging Pillar 3 savings should be explored, the C.D. Howe

[2] Canadian Institute of Actuaries (2007)

institute has recently published a paper that suggests the creation of a new savings vehicle: the Canada Supplementary Pension Plan (CSPP). They suggest the pension model have the following features:

- Automatic enrolment of all non-covered workers (with opt-out provision);
- Use of the CPP/QPP payroll deduction mechanism;
- Operate within the existing tax and regulatory regime for pensions;
- Set an earning floor and ceiling for CSPP deductions;
- Set an automatic default CSPP contribution rate;
- Provide an opt-out option for both employers and employees;
- Provide an opt-in option for both employers and employees (should they choose to opt-out of the default contribution they could contribute by whatever means they cared to within the confines of the existing tax/regulatory system;
- Provide an RRSP assets transfer option;
- Operate at arms-length from government
- Operate as an expert high-performance financial institution: the investment arm of the CSPP would have the mandate of operating and managing a Risk Optimizing Portfolio (ROP) in which each personal retirement saving account could participate. The ROP would operate in a similar way to the current CPP Investment Board by seeking a broadly diversified global return-seeking portfolio. Another portfolio option would be available to CSPP participants with lower risk tolerances;
- A number of annuitization options

The C.D. Howe Institute argues that this would be a cost-effective, transparent, fair and portable saving mechanism for Canadian workers currently without Pillar 3 pension plan membership. It would also help eliminate the problems faced by Canadians currently investing in cost-ineffective vehicles. Agency costs and costs incurred by poor governance are a growing concern; recent studies by Bauer et. al. and Ambachtsheer indicate that management and retail fees can cost investors as much as 2-4% of assets per annum unless they are strongly controlled. They also indicate that scale matters when dealing with pension plans: large-scale plan returns surpass small plan returns by an average of 1% per annum.[3]

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[3] See Ambachtsheer, Keit "Pension Revolution: A Solution to Pension Crisis" John Wiley & Sons, Hoboken, NJ. (2007)

Ambachtscheer, Keith, Ronald Capelle, and Hubert Lum. "The State of Global pensions Fund Governance Today: Board Competency Still a Problem." Working Paper, Rotman International Centre for Pension Management, University of Toronto. (2007)

Ambachtsheer, Keith and Rob, Bauer. "Loosing Ground: Do Canadian Mutual Funds Produce Fair Value for their Customers?" *Canadian Investment Review*, Spring (2008)

The C.D. Howe Institute's estimate of the implications this could have on the average household pension are shocking: a household undertaking to finance a $14,000 pension though private savings can contribute 6% of earnings based on a 4% return rate for the first twenty years followed by a 3% return over the final twenty years (consistent with many investors' wishes to scale down investment risks in later years, in this case, through a 50% conversion of assets into lower-risk deferred annuities.) A well governed large-scale organization delivering an additional 1% per annum would lower the required contribution rate from 6% to 4.5% of earnings. According to C.D. Howe, if the average lifetime annual earning is of $50,000 this would result in a $30,000 savings in contributions.

The second example focuses on the typical Canadian household based on demonstrated investment patters. Most households saving on their own initiative will invest in retail products and will under-perform market returns by at least 2% per annum. This household would now need to up their contribution to 10% in order to meet their pension goal. When measured against the first scenario (a 6% contribution rate) this represents an increase of $80,000 in lifetime contributions. When compared against the second scenario (the person who is reaping an additional 1% return from the plan's economies of scale as well as good governance and who now has to contribute only 4.5% to meet their pension goal) this scenario presents a whopping $110,000 increase in lifetime contributions![4]

Bearing of all of this in mind, the CSPP is fairly attractive proposition. Defined Benefit plans remain preferable in terms of retirement security, and incentives towards these plans should be included wherever possible. However, the trend to move away from DB plans is not likely to be dramatically reversed in the near future and in the meantime; this leaves many Canadians without investments or with underperforming investments. Therefore, CARP recommends that all possible affordable and sustainable options be explored that will encourage and facilitate saving for retirement. The CSPP does not impede on Canadians' rights but it offers incentives that guide them in the right direction.

Recommendations:

- CARP endorses the C.D. Howe institute's proposal for the creation of Canada Supplementary Pension Plan (CSPP).

Bauer, Rob. Et.al. "The Performance of US Pension Funds: New Insights into the Agency Costs Debate." Working Paper, Rotman International Centre for Pension Management, University of Toronto. (2007)

[4] Ambachtsheer, Keith "The Canada Supplementary Pension Plan (CSPP)", *C.D. Howe Institute Comentary: The Pension Papers*. (May 2008)

- The new CSPP would make use of the CPP/QPP payroll deduction mechanism. It would allow more if not all Canadians easier access to a large, well governed and managed plan.

Locked in Funds

Locked in Funds are problematic because they push the bounds of acceptable paternalism in pension legislation. When employees change job positions or move, they are presented with the option of taking their money out of the company pension plan and placing it in Locked-in RRSPs called Locked in Funds (LIFs) or Locked in Registered Accounts (LIRAs). These accounts are a product of late 1980s paternalistic policies aimed at helping people save for retirement. Pensioners with LIFs subsequently have fewer options than those with RRSP: whereas RRSP holders are free to access their funds at any given time, LIF or LIRA holders do not.

Various federal and provincial legislators/legislation dictate the yearly percentage of the principal that retirees may withdraw from their accounts. The problem with this is that seniors may encounter circumstances where they might like to make their own decisions with regard to their investments or where they might need more money than they usually do because of extenuating circumstances. This becomes very complicated for LIF holders. If they encounter very serious difficulties or become terminally ill, they can apply for access but the procedure is painstaking and costly; they have to fill out long applications and are fined 2-6% of amounts withdrawn from their pension. Between 2003 and 2006 30,000 applicants were processed and 27,300 requests were approved, this means that the government has collected millions from people who were trying to collect their own money because of terminal illness or dire need.

Another issue that retirees have difficulty with is clarity. We receive many reports from people who feel they were misled and who didn't know what they were signing up for two decades ago. They are finding their retirement pension plans to be full of nasty surprises. We have previously raised the issue of clarity in this submission and whereas we are proponents of financial literacy and believe that people have a responsibility to educate themselves, there are indications that the pension system was indeed paternalistic and that the values of transparency and communication may not have been as prized as they are today when Locked in Funds were initiated. The entirety of the pension can only be retrieved at age 90 or transferred to a spouse after death. Many Canadians think this is a very unfair scenario because they are often outlived by their pensions and once their pension is inherited, it is later taxed at a higher rate because it is no longer a pension.

Understandably, some may view this as an example of the government profiteering from their money and their death.

Currently, Nova Scotia is behind the rest of Canada in the unlocking of the funds

State of Locked in Funds Across Canada

Jurisdiction	***Legislation***	***Regulatory Commission***	***Unlocking Policy***
Federal	Pension Benefits Standards Act	Office of the Superintendent of Financial Institutions	50% unlocking
British Columbia	Pension Benefits Standards Act	The Financial Institutions Commission of British Columbia	No unlocking*
Alberta	Employment Pensions Plan Act	Alberta Superintendent of Financial Institutions	50% unlocking
Saskatchewan	Pensions Benefits Act	Pensions Division, Financial Services Division	100% unlocking
Manitoba	Pensions Benefits Act	The Manitoba Pensions Commission	50% unlocking
Ontario	Pension Benefits Act	Pensions Plans Branch, Financial Services, Commission of Ontario	25% unlocking
Quebec	Supplemental Pension Plans Act	Direction des regimes de retraite, Regie du Quebec	No unlocking*
New Brunswick	Pensions Benefits Act	Office of the Superintendent of Pensions Department of Training and Employment	25% unlocking
Prince Edward Island	Pensions Benefits Act	Pension Benefits legislation gained royal assent in 1990, but not yet proclaimed	N/A, see Federal legislation
Nova Scotia	Pension Benefits Act	Office of the Superintendent of Pensions	No unlocking*
Newfoundland and Labrador	Pensions Benefits Act	Office of the Superintendent of Pensions.	No unlocking*
The Territories	Pensions Benefits Act	N/A	N/A, see Federal legislation

CARP is an advocate for provincial legislation harmonization in and we would argue that the state of LIFs in Nova Scotia, Quebec, Newfoundland and Labrador pose a disadvantage for residents of these provinces. We would urge the review panel to recommend that Nova Scotia's Locked in Funds policy be made more equitable by following the unlocking policies of the governments such as the Federal government and the government of Saskatchewan.

Recommendation:

- CARP urges the Review Panel to re-examine Locked in Funds legislation and provide enhanced unlocking options for Nova Scotians.

Harmonization

There are several worthwhile arguments to be made in favour of pension regulation harmonization. The International Monetary Fund has stated that this would be a step in the right direction for Canada. Pension plan harmonization would streamline costs and provide inter-provincial equity. It would also facilitate portability and facilitate enforcement. We have recently made a submission to the Expert Review Panel on Securities Reform. In our submission we stressed the importance of investor protection and proposed an **Investor Bill of Rights** that served this primary principle. It is important to remember that the issue of securities reform and investor protection is central to retirement security. As such, we would advise that the Panel also recommend the Nova Scotia government review their securities legislation with this principle in mind.

Recommendations:

- CARP supports pension harmonization because it is cost-effective, equitable, would facilitate portability as well as enforceability.
- CARP recommends the Pension Legislation Review Panel encourage the Nova Scotian government to review their securities legislation to ensure it guarantees investor protection and retirement security.

Mandatory Retirement

A recent McKinsey Global Institute Study indicated that if boomers worked just 1.5 years longer than the median retirement age, the number of households who self-identified as "unprepared for retirement" would be halved. Given the impending skilled labour shortages, provinces should be working in tandem with industry to develop attractive phased retirement packages instead of imposing mandatory retirement.

The Panel states that Nova Scotia will have phased out mandatory retirement by 2009, but as long as the Nova Scotia Human *Rights Act* remains unchanged, this is not necessarily accurate. Section 6 of the Act provides that prohibition of age discrimination does not apply:

> (g) to prevent, on account of age, the operation of a ***bona fide*** retirement or ***pension plan*** or the terms or conditions of a bona fide group or employee insurance plan;

This exemption allows employers who offer a pension plan to terminate their employee's contract on account of age as opposed to ability. The issue couldn't be timelier: just today, the Supreme Court of Canada released its decision in the case of *New Brunswick (Human Rights Commission) v. Potash Corporation of Saskatchewan Inc*. In a 4:3 decision, the Supreme Court held that despite the New Brunswick Human Rights Code prohibition against age discrimination, mandatory retirement would be permitted if there was a bona fide pension plan which allowed it.

The dissenting judges were of the opinion that a provision from a *bona fide* pension plan should be interpreted strictly so that the rights of employees are protected. Some jurisdictions have statutorily mandated requirements to prevent bona fide pension provisions from being used to discriminate on the basis of age. Quebec's legislation requires pensions making age-based distinctions to be "warranted", based on a risk analysis discernible from actuarial data (s. 20.1). The Ontario *Human Rights Code*, s. 25(2), protects pensions that comply with the province's *Employment Standards Act*, s. 44(1) of which prohibits employers from implementing benefit plans that make distinctions on the basis of age. These additional requirements can serve to dismantle disguised mandatory retirement. However, unlike *bona fide* occupational requirements, a *bona fide* pension plan does not engage in any assessment of individual ability to perform work; and therefore, it constitutes a violation of workers' human rights.

Recommendations:

- CARP recommends that the Panel review pension legislation and apply protections for older workers where possible. This could be done by requiring age-based distinctions to be "warranted", i.e. based in risk analysis discernible from actuarial data. This could also be done by preventing employers from implementing benefit plans on the basis of age.
- Pensions Plans should not use age as a criteria for determining when retirement should occur, competence and capability should determine how long a worker can stay in his/her position.
- We also recommend that Nova Scotia amend its *Human Rights Act* to eliminate the exemption for pension plans.

Summary of Recommendations

- The main criteria by which to review the *Pension Benefits Act* should be whether it promotes retirement security followed by integrity and transparency.
- The Panel should consider whether legislation might be amended in order to be more pro-active in encouraging objectives such as increased retirement savings and economic stability.
- CARP recommends that the panel consider reducing funding risks to make DB plans more attractive to employers. It is also a good idea that the Panel examine the effect of new hybrid plan models. While considering these options, the Panel should bear in mind that retirement security remains the central goal of this investigation.
- We recommend that any stipulation obligating DC plan members to roll their pensions into a LIF as of their retirement date be removed. If the funds need to be converted when the member retires, they should be given a reasonable timeframe within which they may chose to purchase an RRSP or a LIF.
- We concur with the Court of Appeal's condemnation of employer-employee communications in the Kerry case. We urge to Panel to consider legislation that would impose on plan sponsors a stricter standard of transparency and clarity when alerting plan members to any changes in plan structure.
- CARP endorses the C.D. Howe institute's proposal for the creation of Canada Supplementary Pension Plan (CSPP).

- The new CSPP would make use of the CPP/QPP payroll deduction mechanism. It would allow more if not all Canadians easier access to a large, well governed and managed plan.
- CARP urges the Review Panel to re-examine Locked in Funds legislation and provide enhanced unlocking options for Nova Scotians.
- CARP supports pension harmonization because it is cost-effective, equitable, would facilitate portability as well as enforceability.
- CARP recommends the Pension Legislation Review Panel encourage the Nova Scotian government to review their securities legislation to ensure it guarantees investor protection and retirement security.
- CARP recommends that the Panel review pension legislation and apply protections for older workers where possible. This could be done by requiring age-based distinctions to be “warranted”, i.e. based in risk analysis discernible from actuarial data. This could also be done by preventing employers from implementing benefit plans on the basis of age.
- Pensions Plans should not use age as a criteria for determining when retirement should occur, competence and capability should determine how long a worker can stay in his/her position.
- We also recommend that Nova Scotia amend its *Human Rights Act* to eliminate the exemption for pension plans.