Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

July 4, 2008

Mr. William A. Black, FSA, FCIA
Chair, Pension Review Panel
c/o Nova Scotia Labour and Workforce Development
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Dear Bill:

The Canadian Life and Health Insurance Association (CLHIA) is pleased to have this opportunity to provide comments to the Pension Review Panel regarding its May 23, 2008 Discussion Paper. The Association commends the government of Nova Scotia for undertaking a thorough evaluation of the challenges and opportunities of retirement income plans, and applauds it for selecting as panellists individuals with recognized expertise and appreciation of the range of views likely to be forthcoming.

As you know, the CLHIA was established in 1894 and is a voluntary association representing life and health insurers accounting for 99 per cent of the life and health insurance in force in Canada, and covering 44 million individuals in over 20 countries around the world. In addition to its roles as employer and sponsor of pension plans for a significant number of workers in Nova Scotia, the Canadian life and health insurance industry has a vital stake in the broader retirement income system for workers and their families.

Canadian life and health insurance companies act as service providers to many defined benefit pension plans for major Canadian and international employers. As well, CLHIA members are principle providers of services to defined contribution (DC) pension plans, group registered retirement savings plans (RRSPs), deferred profit sharing plans (DPSPs), and similar arrangements. Canada's life insurers specialize in the administration of small and medium-size pension plans with about 60% of all pension plans in Canada being funded by insurance contracts (these plans cover one-sixth of the total number of pension

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plan members in Canada). Among DC pensions and similar employer-sponsored plans such as group RRSPs providing member choice of investment options, CLHIA members serve 90% of such plans. These arrangements are typically structured as group annuities - accumulation products that provide sponsors and plan members with flexibility in terms of timing and amount of contributions, a wide range of professionally managed investment options, and guaranteed periodic income streams upon retirement. Today, the industry administers $215 billion in pension, retirement savings plan and other annuity assets.

The current review is one of several that either have been recently or are being undertaken by pension jurisdictions and stakeholders throughout Canada. A joint review in Alberta and British Columbia[a], together with a review in Ontario[b], are ongoing. Other recent consultations and examinations include:

- *Toward Better Funding of Defined Benefit Pension Plans* undertaken by the Régie des rentes du Québec,
- *Strengthening the Legislative and Regulatory Framework for Defined Benefits Pension Plans Registered under the Pension Benefits Standards Act, 1985,*[c] conducted by the federal Department of Finance,
- *Risky Assumptions: A Closer Look at the Bearing of Investment Risk in Defined-Benefit Pension Plans*[d] by James E. Pesando (June 2008) and *The Canada Supplementary Pension Plan (CSPP): Towards an Adequate, Affordable Pension for All Canadians*[e] by Keith Ambachtsheer (May 2008), both part of the *Pension Papers Series* published by the C.D. Howe Institute,
- *A Draft Statement of Principles of Revised Actuarial Standards of Practice for Reporting on Pension Plan Funding*, issued by the Canadian Institute of Actuaries (CIA),
- *Proposed Funding Principles for a Model Pension Law*,[f] as put forward by the Canadian Association of Pension Supervisory Authorities (CAPSA), and

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[a] http://www.ab-bc-pensionreview.ca/

[b] http://www.pensionreview.on.ca/

[c] http://www.fin.gc.ca/activty/consult/PPBnfts_e.pdf

[d] http://www.cdhowe.org/pdf/commentary_266.pdf

[e] http://www.cdhowe.org/pdf/commentary_265.pdf

[f] http://www.capsa-acor.org/capsa-newhome.nsf/257bb0033af16a0a85256c1a00754637/a56ca64622d7abf18525702600433901?OpenDocument

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- *Back from the Brink: Securing the Future of Defined Benefit Pension Plans*,[g] and *Delivering the Potential of DC Retirement Savings Plans*,[h] two reports by the Association of Canadian Pension Management (ACPM).

Canada's life and health insurance companies encourage the Panel to consider each of these reviews and strive to harmonize its recommended approaches and strategies with those of other Canadian pension jurisdictions and pension professionals.

Detailed industry comments with respect to the Pension Review Panel's Discussion Paper are attached. There is a particular emphasis on defined contribution plans and the increasingly positive role that new and innovative solutions play in adding both balance to the pension debate and attractive options for sponsors, plan members, regulators and legislators, within Nova Scotia and throughout Canada.

If the industry can further assist the Panel in its continuing research efforts and the consideration of strategies that will help ensure that Nova Scotians have secure retirement incomes for generations to come, we would be most willing and pleased to do so.

Should you or your colleagues have questions about the industry's comments, or how insurance-based options might address any of the issues facing the Panel, I can be reached by telephone at (416) 359-2021, by facsimile at (416) 777-1895 and by e-mail at rsanderson@clhia.ca.

Yours truly,

Ron Sanderson,
Director, Policyholder Taxation and Pensions

Attachment

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g http://www.acpm.com/docs/ACFD2B.pdf

h http://www.acpm.com/media/2008/dc%20web%20booklet%20eng.pdf

Comments re

Nova Scotia
Pension Review Panel Discussion Paper

May 28, 2008

The Canadian Life and Health Insurance Association (CLHIA) commends the government of Nova Scotia for establishing this Pension Review Panel in order to undertake a thorough evaluation of the challenges and opportunities of retirement income plans.

Comments relating to each section of the Discussion Paper will be noted under the corresponding numbering and headings below. The industry begins with some general comments.

The Pension Review Panel's mandate focuses on identifying any problems in Nova Scotia's current pension legislation and ensuring that pension rules are modern, efficient and beneficial to all employees and employers in Nova Scotia. The industry is very pleased to note that, unlike recent reviews in some other jurisdictions, the Nova Scotia review is meant to include balanced consideration of both defined benefit (DB) and defined contribution (DC) pension plans. Moreover, Canada's life and health insurance companies applaud the Pension Review Panel's clear statement that it is not the role of pension regulators to favour one form of pension over another – "regulators should be neutral as to the format of retirement plans."[1] The industry would encourage the Pension Review Panel to make a similarly clear parallel statement regarding the necessary legislative neutrality vis-à-vis different pension arrangements. The form of pensions, as with other employment compensation and benefits, should be determined solely in light of the economic objectives of specific employers and employees; if reasonable standards are met, form should not be biased by legislative or regulatory preferences.

Before reviewing the questions posed in the Discussion Paper, the industry notes that the paper contains a number of descriptions of current practices and impacts of DC pensions and RRSPs that do not, in the industry's view, accurately reflect contemporary practices; the industry would like to provide an alternate view of those descriptions.

[1] Paragraph 2, Section 4.7 *Roles of Regulators*, of the Discussion Paper.

An alternative view of current DC pension and RRSP practices

The Discussion Paper notes that "some suggest that DB plans should be encouraged, as they are the best way for individuals to save for retirement."[2] While the Discussion Paper notes that employers may be disinclined to offer DB plans, it neither justifies nor refutes the suggestion that such plans are "the best way… to save for retirement." Unfortunately, reproducing this statement suggests that the neutrality re plan design that is demanded of regulators has not been fully reflected in the Discussion Paper.

The Paper then quotes former Bank of Canada Governor David Dodge as "encouraging employers to maintain DB plans and confirm their importance as an economically efficient way of transferring risk to those that are best able to bear it."[3] These remarks were made in the context of DB pension plans as a source of professionally managed pools of investment capital; they did not address a range of factors that relate to the relative merits of DB and DC pension plans.

Dr. Dodge's remarks started by considering the reportedly inadequate performance of DC pensions[4] and RRSPs based on poor investment selection by plan participants, external

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[2] Paragraph 1, Section 4.1, *Defined Benefit (DB) Plans versus Defined Contribution (DC) Plans*

[3] The quote is reported in Towers Perrin, *The 21st Century Pension System: Solving the DB Funding Conundrum* (January 2008) at 3, online: Towers Perrin http://www.towersperrin.com/tp/getwebcachedoc?country=cane&webc=HRS/CAN/2008/200801/DB_Funding_Conundrum.pdf ; it is taken from *Economic and Financial Efficiency: The Importance of Pension Plans*, a November 9, 2005 speech in Montreal to l'Association des MBA du Québec, the full text of which is available at http://www.bankofcanada.ca/en/speeches/2005/sp05-14.pdf.

[4] The oft-repeated alleged inadequacy of pensions and other retirement-focused savings under non-DB arrangements has reached ludicrous proportions. For instance, the July 4, 2008 on-line version of Benefits and Pension Monitor (http://www.bpmmagazine.com/benefits_news.html) included the following report:

> ***Few DC Members Will Meet Retirement Needs***
>
> *Less than one in five employees who participate in their companies' 401(k) plans will be able to meet all of their estimated needs in retirement, says research from Hewitt Associates, When inflation and increases in medical costs are included, Hewitt predicts employees will need to replace about 126 per cent of their final pay at retirement. This is significantly more than the traditional estimates of 70 per cent to 90 per cent of pay replacement.*

Since it is highly unlikely that any DB plan would provide an income replacement ratio in excess of 70 percent, the headlines' reference to DC plans seems to bear no connection to the economic substance of the report, and would appear to reflect a pejorative attitude re non-DB plans.

macro-economic factors, particularly at the cusp of retirement, (both of which represent "return risk") and "longevity risk" (whereby the period over which accumulated funds are liquidated is shorter than an individual's actual survival period). The speech argued that the pooling of risk and professional asset management found in DB pension plans minimizes both risks, allowing for more efficient use of invested capital within the national economy.

Dr. Dodge's speech continued by noting that individuals managing their own investment portfolios within DC pension plans and RRSPs are risk averse. They tend to invest more extensively in investment-grade bonds, money market instruments and large-cap equities relative to the portfolios of DB pension plans. Dr. Dodge concluded that this fails to maximize the expected retirement incomes of DC pension plan members and holders of RRSPs. By contrast, Dr. Dodge noted that professional asset managers have both the ability and desire to use alternative asset classes and arbitrage strategies to enhance returns within DB pensions.

Dr. Dodge seems unaware of the extensive role of professional asset management in both RRSPs and DC pension plans. While "stock picking" of individual securities may be possible in some plans, the investment offerings in many plans have been simplified to the extent that plan members require little or no investment expertise and yet still benefit from professional investment management (often in the same investment pools as DB plans). "Selecting" from one balanced fund is purely an administrative matter. Similarly, even with more numerous investment offerings available, the choices are almost invariably widely diversified, professionally managed offerings that therefore have built-in risk protection.

In addition, "lifestyle" or "target-date" investment funds have become increasingly common, whereby professionally-designed and managed asset allocation models automatically adjust investment selections across risk categories (duration, industrial sector, location, currency, volatility, etc.) to match the yield and cashflow requirements appropriate to the cohort to whom the fund is targeted. Such funds are replacing money market and balanced funds to become the norm for default investment options within DC pensions and employer-sponsored group RRSPs, further protecting plan members who are not fully engaged in or lack experience and/or knowledge that would allow them to capably manage their retirement income plans. As well, plan members can always avail themselves of investment information and advice, particularly in the smaller case market. And it should be noted that unlike the US, Canadian pension plan investment rules prevent excessive exposure to employer stock in DC plans.

As retirement approaches, DC pensions and RRSPs address longevity risk by migrating such investments into insured annuities that provide guaranteed fixed incomes for life,

commencing at the chosen retirement date. By staggering the dates at which guaranteed annuity incomes are purchased, DC pensions – and to a less well developed degree at present, RRSPs – can minimize the risk that adverse annuity prices at the point of retirement could lead to depressed future incomes. Alternatively, such plans can retain potential positive investment returns with no down-side risk and guarantee a periodic return of accumulated capital in the form of "guaranteed minimum withdrawal benefit." "GMWB" options within segregated fund-based annuity contracts issued by life and health insurance companies are described in greater detail in section 3.1 below. The success of GMWB plans is clearly demonstrated in the individual RRSP and non-registered savings market; within twenty months of its introduction of a GMWB product into Canada, one life insurance company reported over $5 billion in sales. A version of that product tailored to group retirement plans has subsequently been introduced, and similar vehicles are expected from other providers in the near future.

Dr. Dodge's speech identified several ways in which governments could promote the creation and continuation of DB pension plans. Perhaps through lack of familiarity with current DC pension plan and RRSP features, he failed to acknowledge that evolving risk mitigation strategies currently at play on an "auto-pilot" basis in a variety of retirement income plans can accomplish similar economic objectives to DB plans at both the personal and national levels. Unfortunately, Dr. Dodge's remarks may make it easier for those with a bias toward DB plans to inappropriately use his remarks to support that bias.

Contrary to Dr. Dodge's remarks, transfers of return and longevity risk to employers as pension plan sponsors may not, in fact, represent a transfer of risk to "those that are best able to bear it". CLHIA members would argue that Canada's life and health insurance companies are, in fact, in the business of transferring, managing and mitigating risks, and have the track record to prove that insurers are better able to bear and manage such risks than pension plan sponsors or plan members.

3. Pension Plan Legislation

The "pension promise" is frequently interpreted in a DB context to reflect a sponsor's obligation to fund a pension plan in such a manner that the Administrator can pay benefits according to a pre-determined formula. To the extent that a pension promise is acknowledged in a DC context, that promise might be characterized as being to contribute to the plan as agreed, and to provide appropriate and relevant information to plan members to assist them in managing their investments within the plan in a prudent manner. And as noted above, DC plans typically enhance that promise by providing professionally managed defaults, investment information, advice and detailed performance reporting.

The goals of pension legislation and regulation enumerated in the Discussion Paper are intended to support the delivery of these promises. To the extent that delivery of pension promises are adequately protected through less onerous methods such as voluntary industry guidelines or self-regulation of industry participants, prescriptive legislative or regulatory measures should not be necessary. Indeed, CLHIA members strongly encourage a principles-based approach to legislation and regulation, with sufficient flexibility incorporated to allow all pension stakeholders the opportunity to enhance pension plan options and benefit security without undue restrictions.

Canada's life and health insurance companies would not recommend any expansion of the legislative and regulatory goals identified in the Discussion Paper.

3.1 Types of Plans

Historically, DB pension plans were entirely based on annuities that provided plan members with fully guaranteed lifetime income benefits. Throughout the last several decades, sponsors and Administrators have assumed that investments in equities would provide superior long term returns, with the result that pension funds have typically mismatched incoming cash flows from equity investments with the more bond-like outflows characteristic of the retirement benefits payable under such plans. This difference can be exacerbated when equity values or returns are depressed.

Whether an "equity premium" truly exists is debatable, both in terms of absolute yield and the timing of variations in yield. In order to address these fluctuations, DB plans can shift a portion of their assets to bonds in an effort to better match asset and liability cash flows. Or they can purchase guaranteed annuities from life and health insurance companies to fully immunize the pension plan from such differences. Of course, offloading risk carries a price, and consultants to DB plans have frequently argued that the cost of offloading benefit obligations to insurers is excessive.

As noted previously, two frequent criticisms of DC plans are inefficient, member managed, investment selections and their assumed sensitivity to rates of return at the instant of retirement, when accumulated values may be used to purchase a guaranteed income annuity. Related to both issues is the assumed high cost of investment management within DC pensions.

It should be noted that DC pensions tend to have far smaller asset values than typical DB plans, and investment costs are largely dependent on scale. Where DC plans provide managed default investment options, it is likely that the pure investment management costs would be comparable to a DB plan of similar scale.

In response to David Dodge's remarks, the industry has already noted that DC plans can provide guaranteed income benefits in at least two forms, using traditional lifetime annuities backed by bonds and mortgages, and recently developed "guaranteed minimum withdrawal benefits" whereby the bulk of the assets are retained within managed equity portfolios, while funds sufficient to insure that all guaranteed payments are made are managed on a transferred risk basis by the insurer.

These approaches to DC plans reflect a significant reduction in member risk for DC pension plan participants. Such products are continually evolving to better address consumer needs, and the industry would discourage the creation of a legislative or regulatory framework that prevented such evolution.

While government-managed multi-employer pension plans (MEPPs) have been suggested as ways of creating more cost effective DB pensions within small employment situations, the need for such plans is unclear. Modern DC plans can and do already offer comparable benefits within the existing regulatory framework. To the extent that investment options within such plans are increasingly standardized, unit costs will be further reduced, providing increasing income benefits to plan participants. Legislative and regulatory models that recognize the reduced need for regulatory supervision of DC plans may be a more effective means of expanding pension coverage than development of other more heavily supervised models. And through partial annuitization of accumulating values, such plans effectively provide a continuum of hybrid pensions, combining the certainty of guaranteed income benefits with the potential to add value through active professional investment management.

Thus, Canada's life and health insurers see significant value in maintaining flexibility in permitted pension plan designs within the framework of the existing DB and DC plan "building blocks".

4.1 DB vs. DC Plans

Consistent with the Discussion Paper's statement that "regulators should be neutral as to the format of retirement plans", Canada's life and health insurance companies consider the question of whether "the current trend towards less (sic) DB plans (should) be accepted" inappropriate. Quite simply, there is nothing for regulators to accept: the trend exists, like it or not.

The more relevant questions appear to be whether regulators should encourage one form of pension arrangement in preference to others, and whether funding risks can be diminished. As noted above, the Panel has already expressed its view that regulators should be neutral

regarding plan design. With respect to funding risks, there is a long-standing argument that addressing funding limits and asymmetry with regard to sponsor and member rights to access to plan surplus would slow or possibly reverse the decline in DB plans. But it should be noted that, even without these concerns, the reduction in large-scale employers with unionized workforces significantly diminishes the number of situations where the high fixed administrative and compliance costs of creating and maintaining a DB pension plan would be palatable.

Section 3.1 above describes some mechanisms for enhancing investment performance within DC pension plans where plan members currently make investment choices. Increasingly, there is a sense that using default target-date managed funds would better serve many DC participants, and it may be appropriate for plans to automatically assign such defaults unless the participant explicitly acknowledges his or her own responsibility for the level of income ultimately arising from the plan. Appropriate selection of default options would continue to be an obligation of the sponsor, in accordance with the *Pension Plan Governance Guidelines and Self-Assessment Questionnaire* established by the Canadian Association of Pension Supervisory Authorities (CAPSA).[5]

As also noted in section 3.1 above, legislative and regulatory frameworks should not preclude flexibility in plan design that can respond to changing market requirements. A results-oriented, principles-based, approach to pension legislation and regulation would appear to be most responsive to changing needs, and would be preferable to any attempt to pre-determine appropriate plan parameters and thereby restrict future plan development.

The selection of different forms of income always carries some consumer risk. While plan participants should not be unduly restricted in the forms of income that they might select, such breadth of choice implies an increased educational obligation that plan participants may not be prepared to assume. This may leave the plan sponsor and Administrator with some significant risk, since it is not unlikely that a plan member may launch legal action alleging that the sponsor and Administrator were derelict in their duty to inform or protect the plan member from "acting independently to his or her own detriment".

In recent years, several Canadian pension jurisdictions have moved to permit alternative payment patterns from pension plan that would mimic those payable under Registered Retirement Income Funds (RRIFs) that have received transfers of funds from pension plans. Such RRIFs are variously referred to as Life Income Funds (LIFs), Locked-in Retirement Income Funds (LRIFs), and Prescribed RRIFs (PRIFs). The range of

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[5] CAPSA Guideline No. 4, released October 25, 2004. http://www.capsa-acor.org/capsa-newhome.nsf/4a5938dfa169be3285256c1a00752c5d/c23e35f57379385a85256f62007038ab/$FILE/Guideline%20No.%204%20-%20ENG.pdf

variations in such arrangements – whether modeled on a RRIF "platform" or within a pension plan – significantly increases administrative cost and complexity.

Canada's life and health insurance companies appreciate the desire for a range of benefit options, but encourage both legislators and regulators of pensions throughout Canada to strive to minimize variations in structures that are essentially inconsequential, but that add significantly to the costs that are ultimately borne by plan sponsors and participants.

The discussion of DC plans in paragraph five of section 4.1 identifies "high fees" as a shortcoming of such plans. The industry is not aware of any valid comparisons of cost structures under DB and DC pension plans that accurately differentiate the significantly different services provided by the two classes of plans, such that an objective comparison of fees is possible. In terms of pure investment management costs, there should be clear advantages of scale that favour defined benefit plans, since they typically have significantly larger total assets under administration. But this is not a fundamental structural cost differential between DB and DC plans and any difference in costs should be expected to diminish over time as assets administered under DB and DC plans approach parity.

DB plans clearly have significant regulatory compliance costs, such as mandated actuarial valuations, that increase their costs. While DC plans may have lower compliance costs, they have significantly greater member information, education and reporting costs, given the relatively greater member involvement in investment selection. Canada's life and health insurance companies believe that it is inappropriate to focus on any fee differentials without recognizing the material differences in, and value of, services provided.

4.2 Pension Plan Funding

The determination of the adequacy of pension plan assets relative to projected liabilities is an ongoing obligation of the pension plan Administrator, subject to monitoring and supervision by the regulator. In order to ensure that such determinations are objective, they are normally undertaken by actuarial consultants not associated with the sponsoring employer(s), operating under the applicable standards of practice of the Canadian Institute of Actuaries in accordance with the standards prescribed by relevant pension legislation and regulation, and any administrative standards of the regulator.

Any revision to applicable legislation, regulation or governing standards may have an impact on the valuation of plan assets and liabilities. For instance, recent consultations by the federal Department of Finance and the Régie des rentes du Québec elicited recommendations for the adoption of more flexible permitted funding methodologies to

address solvency deficiencies, and these recommendations have been implemented via Québec's *Act to amend the Supplemental Pension Plans Act, particularly with respect to the funding and administration of pension plans* (Bill 30) and federally as the *Solvency Funding Relief Regulations* under the *Pension Benefit Standards Act, 1985*. Such funding approaches may require the adoption of specific techniques to value any resultant changes in funding practices. But since these changes are made within the context of sound plan governance and prudent plan administration, such changes in funding and valuation should not cause dramatic or material variations in the operation or solvency status of the pension plan.

From a regulatory perspective centred on the security of benefits under a pension plan, it can be reasonably argued that regulatory valuations should be conducted only on the basis of a potential wind-up; that is, solvency valuations should be the only valuation required for regulatory purposes. An exception exists with respect to the addition of benefits, where it would be reasonable to expect those benefits to be funded on a going-concern basis over a relatively short period of time, perhaps five years, rather than being required to be funded on a lump-sum basis. Canada's life and health insurance companies support this streamlined, risk-based, approach to valuation.

The Discussion Paper notes the current variations in the solvency funding rules for certain public sector and multi-employer pension plans. The industry is very concerned that evolution of plan designs and funding arrangements, including exceptional funding deferrals within public sector plans, has created a widening gap between the benefits and rules relating to public service pension arrangements and those found in the private sector. Since funding of public sector plans relies on government revenues, the ability to adjust revenue in order to ensure long-term sustainable funding of public plans is given. Consequently, the ability to offer enhanced benefits within public plans has created a significantly different approach to and perception of plan designs, entitlements and funding, and may be reflected in unreasonable expectations for private sector plans that may not have the same flexibility.

A similar disconnect may exist with respect to multi-employer plans. Since multi-employer plans are subject to collectively-negotiated funding levels, it would appear that no legislatively or regulatorily mandated funding mechanism initiated after negotiation of such an agreement should impose alternative funding requirements within the term of such an existing collective agreement. It may be appropriate to mandate full disclosure of the funding status of a multi-employer pension plan as part of future collective agreements, such that informed decisions regarding any proposed funding schedule can be reasonably reviewed by employers and plan members. It may not be appropriate, however, for regulators to impose a funding schedule, given that plan funding would be part of the

negotiated collective agreement and the option of benefit reduction would continue to apply.

The creation of a single province-wide plan for public sector employees could provide enhanced efficiencies and economies of scale resulting in reduced fees. Unfortunately, concentration of investment style may increase risk and produce contagion effects that would be limited via smaller plans or if management of plan assets within a single plan were subdivided and apportioned to independent investment management teams. Operation as a multi-employer plan could preserve differential benefit levels within the context of separate member organizations, but may not optimize potential cost savings.

Correction of plan funding deficits is most material upon plan wind-up, and the Discussion Paper raises an important question regarding whether full funding of such deficits should be required. Given the potential for litigation surrounding this issue, it is perhaps the most important topic where nationally harmonized standards and approaches need to exist. As such, a full discussion of options goes beyond the scope of this review. However, Canada's life and health insurance companies strongly encourage the Panel to recommend that this issue be raised before an appropriate forum, such as the Canadian Association of Pension Supervisory Authorities, where broad consultations, and recommendations to respective Ministers responsible for pensions, can be undertaken.

While the Discussion Paper notes that solvency is only an issue for DB plans, solvency is not the only issue associated with funding. Benefit adequacy is directly tied to funding for both DB and DC plans. Section 4.7 of the Discussion Paper notes that "regulators should not attempt to regulate the adequacy of retirement income" but section 4.8 appears to counter this position by indicating that group Registered Retirement Savings Plans "could lead to insufficient pension savings". While the reference to "pension" is clearly intended to refer to retirement incomes generally, there appears to be an unsupported presumption that retirement plans that are regulated under other than pension regimes are fundamentally at greater risk of failing to provide desired retirement income levels than are plans subject to pension regulation. Canada's life and health insurance companies do not believe that such a presumption has been proved or is, in fact, provable.

Notwithstanding this seeming inconsistency, the point must be made that limits on plan funding ultimately impact benefits payable. Current funding limits may be predicated on assumed periods of active employment, investment returns and life expectancies that are no longer reflective of rationally expected results, with the result that benefits payable are not "adequate" by any objective standards. It may therefore be appropriate to revisit any legislative limits on funding levels for DB and DC pension plans, and for other retirement savings arrangements such as RRSPs, both within Nova Scotia and more broadly.

4.3 Surpluses

The debate between representatives of pension plan sponsors and plan members over ownership of surplus within DB pension plans is longstanding. Sponsors argue that since they are responsible for funding any shortfall resulting from poorer than anticipated investment performance, equity demands that they be similarly entitled to any surplus due to higher than anticipated investment yields. By contrast, labour argues that amounts contributed to a pension are held in trust for the exclusive benefit of plan members, even where the resultant benefits would exceed the promised benefits.

As noted above, the pension promise within DB pension plans reflect a sponsor's obligation to fund a pension plan in such a manner that the Administrator can pay benefits according to a pre-determined formula. Those benefits are periodic amounts that are frequently compared to deferred wages. That is, the promise relates to periodic income, not the capital necessary to provide that income. To interpret the promise otherwise would be analogous to replacing an employee's right to salary with a shareholder's ownership rights in a company. No reasonable analysis of the pension promise could rationalize such a substitution.

Any right to salary is obviously contingent on the ongoing viability of the enterprise employing an individual. That is, such a right is a contingent right at best, and not an absolute right.

Prudent pension management would suggest that purchase of guaranteed income annuities for plan participants is an appropriate means by which to ensure that promised benefits are actually paid. By ensuring that promised benefits are payable, arguments supporting member claims on plan surplus could more readily be countered or limited.

Canada's life and health insurance companies strongly support efforts to resolve the existing ambiguities with respect to access to surplus. Absent clear legislative intent or plan text, pension regulators are currently burdened with attempting to adjudicate between conflicting claims, and those claims frequently give rise to litigation. There may be merit in following the Quebec model, whereby any surplus sharing between the sponsor and plan members is negotiated under the mandated wind-up process.

4.4 Multi-Employer Pension Plans

While DB-style multi-employer pension plans should be subject to solvency testing comparable to other DB plans, the response to funding shortfalls may differ from those strategies applicable to non-MEPP DB plans.

For non-MEPP DB plans, funding deficiencies can be addressed immediately by changes in employer funding levels. But as noted in section 4.2 above, the collective agreements between employer and employee groups participating in multi-employer pension plans make adjustment of plan terms, including negotiated contribution rates and benefit provisions, during the term of any collective agreement problematic. Similarly, it is unreasonable to suggest that statutory or regulatory changes to pension requirements should be imposed during the term of such agreements.

Increased funding levels sufficient to offset deficiencies could be imposed on otherwise negotiated funding arrangements as part of subsequent collective agreements, subject to reasonable timelines and caps on restorative funding rates that do not materially reduce net salary levels relative to those in effect under the prior collective agreement.

Hybrid MEPPs, in which voluntary employee contributions can be used to compensate for such deficiencies and thereby partially restore benefits if and when funding deficits occur, may require adjustment of otherwise applicable limits to funding. Such approaches may significantly complicate plan administration and supervision. Moreover, they may obscure and perpetuate failures in a plan's governance and investment management processes.

Flexibility in plan design should be permitted under pension legislation and regulation in all jurisdictions in Canada; narrowly prescriptive limits on plan design interfere with the development of plans appropriate to the specific needs of employees and employers, and should not be adopted.

4.5 Governance

Continually evolving economic and employment environments makes the value of a static definition of good pension plan governance of limited value. Similarly, maintaining legislation of behaviours reflecting even minimal measures of good plan governance would be challenging at best. CLHIA members recommend a more goals-oriented approach.

The Discussion Paper notes the 2004 adoption by the CAPSA of the *Pension Plan Governance Guidelines and Self-Assessment Questionnaire.*[6] These benchmarks represent best practices as recognized by a wide-ranging group of stakeholders – employers, organized labour, service providers, and regulators – in Canada's pension system.

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[6] Idem.

Similarly, pension, insurance and securities regulators, through the Joint Forum of Financial Market Regulators', released *Guidelines for Capital Accumulation Plans*[7] in 2004 that contain a significant governance component with an emphasis on due diligence in selecting and monitoring service providers and investment options. These guidelines were developed through an exhaustive consultation process with a wide range of stakeholders in employer-sponsored, tax–assisted group savings arrangements that provide individual plan participants with the ability to make investment choices.

Standards of what constitutes good governance can be expected to evolve. Since the CAPSA guidelines are relatively new and no thorough review of their effectiveness has, as yet, been conducted, there would appear to be no proven need to reinforce their effectiveness by means of incorporating them or alternative governance provisions into pension legislation or regulations in Nova Scotia.

Prudent governance includes measures that are both independent of the size and style of a pension plan and processes where costs will vary in relation to the size of any particular plan. Quantifying costs as a function of plan size, design or operation will not give rise to fixed unit cost ratios, and would therefore make it impractical to prescribe "appropriate" governance costs.

Good governance, of course, includes a monitoring of plan costs, including the costs of governance; where these costs are inconsistent with those incurred for comparable services and processes in comparable plans, good governance would recommend consideration of alternate approaches or use of alternate service providers, in order to deliver optimal value to plan stakeholders.

4.6 Harmonization

The Discussion Paper notes the long-standing efforts of CAPSA and a large group of pension stakeholders to develop a model pension law that would hopefully be adopted by all Canadian pension jurisdictions. But recent experience has demonstrated significant tendencies to customize pension legislation, regulation and administration within specific jurisdictions.

Canada's life and health insurance companies appreciate the motivations for such customization, but would underscore that the effect of such variations is to increase the

[7] Joint Forum of Financial Market Regulators: *Guidelines for Capital Accumulation Plans*, issued May 28, 2004. http://www.jointforum.ca/JF-WWWSite/attachment/final%20docs/Guidelines-ENG%20final.pdf

complexity of pension administration and compliance, and for many potential plan sponsors, the resulting path of least resistance is to not offer a pension plan.

As noted elsewhere in these comments, the *Guidelines for Capital Accumulation Plans* represent a non-legislative, non-regulatory, consensus-based approach that harmonizes regulation of member choice savings plans across all geographic jurisdictions in Canada and across pensions, securities and insurance sectors. They represent one of the best examples of the power and efficiency of broad, principles-based efforts to harmonize outcomes, without resorting to mandated processes.

CLHIA members strongly encourage pension regulators, and perhaps more importantly, legislators, to emulate the consultative and harmonizing model embodied by the "*CAP Guidelines*", and to forego unique localized solutions where adoption of consistent national approaches or precedents established in other Canadian jurisdictions would accomplish substantially similar results.

Recognition that different pension designs may warrant different legislative and regulatory models may contribute to a revitalization of employer-sponsored pensions within the broader range of workplace retirement savings and income options. Moreover, adoption of a principles-based model for pension legislation, whereby governments determine broad policy objectives but the specific means by which those ends are obtained may be open to different strategies and methods developed by the regulated entities, would appear to offer a more responsive approach to the evolving needs of dynamic economies than might a system centred on prescribing inflexible processes by which those outcomes are expected to be achieved. Such a model would continue to be supported by strong plan governance and risk-based supervision.

Principles-based systems are more readily harmonized with other pension jurisdictions, and such harmonization is increasingly important to the efficient operation of pension plans in a globally competitive environment. Harmonized, principles-based approaches are increasingly the regulatory norm and are being successfully applied in the insurance sector; CLHIA members encourage pension reforms in Nova Scotia, and throughout Canada, that reflect a principles- and risk-based approach.

4.7 Role of Regulators

The Discussion Paper notes that the Superintendent is empowered to make orders with respect to pension plans, and that a plan Administrator has a right of appeal with respect to such orders. It should be noted that this right of appeal is not restricted to Administrators, but applies to any person to whom the order is directed.

The Discussion Paper questions whether pension plan regulation should be contingent on the number of members within a given plan, possibly focussing on plans with larger numbers of members.

From a policy perspective, it would seem inappropriate to limit the protection that is assumed to flow from regulation of pension plans to a subset of those plans. Indeed, if such a differentiation were to be made, it might be more reasonable to provide such protection to plans with fewer members, on the assumption that the costs of such plans might be higher, or the sophistication of plan Administrators might be limited, leading to potential lapses in plan governance and/or administration. The contrasting view is that smaller plans tend to be more reliant on professional service providers and may actually have more robust governance and higher administrative standards than larger plans that are managed "in-house", possibly with limited expertise or professional advice.

A more reasonable distinction in regulatory oversight may be to focus on the governance and compliance risk of specific plans. Clearly, a DC plan managed by a regulated, third-party financial institution may have significantly reduced risk of non-compliance relative to a small, internally managed, DB plan with a history of under-funding. Regulatory oversight would reasonably be expected to focus on the latter plan, and not the former, while reserving the right to monitor and respond to compliance issues for all registered pension plans.

4.8 Group RRSPs

RRSPs are not regulated under pension legislation, but Canada's life and health insurance companies consider it incorrect to describe such plans as "not regulated". There are extensive provisions under the *Income Tax Act* (Canada) governing funding, investment options, appropriate forms of retirement income and access to accumulating values prior to plan maturity. Rather than there being no vesting period, employer contributions vest immediately, providing greater immediate value to plan participants. Any limitations to access to funds held in RRSPs flow from employment agreements and (more likely) contractual provisions, rather than being based in a governing statute. While employers may be able to unilaterally change investment options or contribution rates, this flexibility is limited by collective agreements and employee relations management issues.

Pension regulators clearly view group RRSPs as competing arrangements vis-à-vis pension plans, and frequently suggest that such plans are not subject to comparable extensive consumer disclosure standards. As noted above, the *Guidelines for Capital Accumulation Plans* provide extensive *de facto* regulation of such plans that is broadly comparable to that

mandated under pension law. These guidelines have been further endorsed by service providers, and are reflected in National Instrument 81-404 and an amendment to NI 45-106 for securities issuers, and are incorporated in the CLHIA's guidelines for its members. The "*CAP Guidelines*" represent an outstanding example of how principles-based governance can achieve desired public policies and equivalent operational environments without reliance on identical legislative or regulatory mechanisms.

The Discussion Paper notes that "RRSPs can be used all at once", although it should be noted that tax implications provide a significant disincentive to do so. And evolving liquidity provisions within pension plans, providing cash-out rights due to migration, financial hardship, reduced life expectancy, small balances and recently developing partial liquidation rights on termination of employment provide increasing access to pension plan assets as well.

Canada's life and health insurance companies are also concerned that this section of the Discussion Paper concludes by suggesting that use of group RRSPs "could lead to insufficient pension savings". Aside from the conflict with section 4.7 which correctly notes that "regulators should not attempt to regulate the adequacy of retirement income", the suggestion that the risk of "insufficient pension savings" would be mitigated by regulation under pension law is not substantiated. The risks associated with poor investment selection within RRSPs are identical to those existing under DC pension plans in which plan members exercise investment choice. But in both cases, plan designs and on-going educational support consistent with the *Guidelines for Capital Accumulation Plans* provide significant means by which poor investment decisions can be avoided, or monitored and corrected.

4.9 Unlocking Funds

The historical purpose of a pension plan was to provide retirement income. This view was rooted in the "job for life" economic model that generally prevailed until the latter decades of the 20th century.

Since then, the pace of economic change, leading to changes in working relationships, has only accelerated. Technical and social changes leading to changing educational and job requirements have greatly reduced employment stability, increasing the demand for both geographic and employment mobility. In turn, these pressures have led to increasing demand for early access to pension funds in order to finance a widening range of economic needs.

While this conflicts with the traditional and paternalistic focus on ensuring the protection of retirement income, there are legitimate needs for pre-retirement access. Criteria vary throughout Canada, but Canada's life and health insurance companies consider existing unlocking provisions relating to reduced life expectancy, financial hardship, becoming a non-resident and in the case of small member balances to be adequate to meet most needs. Indeed, the industry supports a comparatively liberal adjudication of requests for unlocking on the basis of financial hardship.

At the same time, the industry supports the view that funds accumulating within pension plans should normally continue to be used to provide retirement income, and that the unlocking of funds "simply because a member wants to unlock them" does not appear to satisfy the existing policy objectives of pension legislation. No clear public policy rationale for expanded unlocking of funds appears to have been put forward. Although maintaining the existing restrictions on unlocking may place regulators in the role of making subjective determinations of the merit of requests to unlock funds, the alternative may be to significantly reduce the effectiveness of pension regimes generally.

The industry supports a continued legislative and regulatory focus on ensuring that funds sourced in pension plans be preserved so as to provide reasonable incomes in retirement, rather than form a routine part of pre-retirement discretionary and disposable income. This focus should continue to be moderated in cases of demonstrated need, or where retaining funds within a retirement-focused arrangement has minimal value for Nova Scotians.

4.10 Grow-In Benefits

The provision of grow-in benefits has been a significant transitional measure in circumstances where plans are wound up in part or in entirety, and where limited opportunities for re-employment exist. As economies expand and diversify, and especially as long term employment relationships are replaced by more frequent changes in employment, the necessity for broadly applicable grow-in rights should be expected to diminish.

Reflecting the increasing mobility of labour, Canada's life and health insurance companies consider the need for grow-in rights to be reduced relative to any historical needs for such rights, and favours the reduction and eventual elimination of grow-in rights in all jurisdictions.

5.1 "Safe Harbour" Rules

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 measures in order to take advantage of the safe harbour provisions is reportedly difficult, if not impossible, to verify. A presumption that safe harbour rules 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 sponsor or service provider has acted with appropriate diligence.

Suggestions for safe harbour provisions within Canadian pension jurisdictions have not generally led to such actions. 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 do 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.

By contrast to a legislated safe habour based on a minimum standard, the Canadian regulatory approach, as exemplified by the Joint Forum of Financial Market Regulators' development with stakeholders of the *Guidelines for Capital Accumulation Plans*, and the parallel development of CAPSA's *Governance Guideline and Self-Assessment Questionnaire*, has been one of developing cultural compliance with voluntary best practices. In effect, compliance with these governance standards and operational processes provides a *de facto* safe harbour, making a legislated safe harbour redundant.

Within the DC pensions and group RRSP 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 evolution of plan design and sponsors' internal governance objectives.

5.2 Phased Retirement

The recognition of longer life expectancy has led to the elimination of mandatory retirement in some jurisdictions, with the resulting demand for mechanisms that would allow individuals to draw pension benefits while continuing to work on less than a full-time basis with the same employer, thereby continuing to accrued service that will ultimately translate into higher value retirement pension benefits at a future date.

While these measures may be viewed positively by some individuals, it may be unreasonable to require all pension plans to provide such alternative forms of access. CLHIA members therefore recommend that pension legislation permit, but not require, the provision of alternative forms of benefits to address the particular needs of plan members, consistent with the broad goals of retirement benefit security.

5.3 Tax Free Savings Accounts (TFSAs)

TFSAs are nominally targeted at lower-income individuals as, among other objectives, an alternative to RRSPs, since such individuals could suffer clawback of social benefit payments as a result of withdrawal of taxable funds from RRSPs; since TFSAs do not produce taxable income, an individual's eligibility for social benefits is not diminished by receipt of benefits out of a TFSA.

In addition, TFSAs provide a tax-advantaged savings opportunity for individuals who have already maximized savings potential within pensions, RRSPs, and similar vehicles; for this cohort, TFSAs can be expected to cause the transfer of existing savings and investments from taxable arrangements such as "open" mutual fund accounts.

This latter group is expected to quickly maximize use of TFSAs, and the TFSA contribution limit might be viewed as corresponding to increased RRSP contribution limits of approximately $10,000 annually (i.e., the equivalent pre-tax contribution to an RRSP, assuming a 50% composite provincial-federal marginal tax rate). Lower-income individuals, as evidenced by the massive amounts of unused RRSP contribution room, do not, generally, have sufficient discretionary spending capability to be expected to be significant users of TFSAs. For most lower-income individuals, the plan choice may be driven by tax deductibility of contributions; the long-term tax impact of RRSPs or TFSAs is not likely to be a determining factor in contribution decisions.

TFSAs are primarily intended as short-term savings vehicles. The ability to withdraw funds from TFSAs for any purposes makes their character fundamentally non-pension-like. While some sponsors may offer "group TFSAs" as ancillary plans or as an alternative to

group RRSPs, they will not be an alternative to mandatory DB or DC pension plan participation where pension plans are offered. As a result, and since creditor protection should be available via both trust-based and annuity-based TFSA structures, there would appear to be little if any reason for or advantage to bringing TFSAs within the ambit of Nova Scotia's pension legislation.

CLHIA members recommend that Nova Scotia parallel the federal treatment of TFSAs such that TFSAs are not treated as pensions, nor should they impact either social benefit entitlements or benefits provided under pension plans.