ACPM Brief to the Government of Nova Scotia

Department of Finance

Mechanisms for Enhancing the Retirement Income System in Canada

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ACPM/ACARR

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FOREWORD

The Association of Canadian Pension Management (ACPM)

The Association of Canadian Pension Management (ACPM) is the informed voice of Canadian pension plan sponsors, administrators and their allied service providers. Established in 1976, the ACPM advocates for an effective and sustainable Canadian retirement income system through a nonprofit organization supported by a growing membership and a team of volunteer experts. Our members are drawn from all aspects of the industry from one side of this country to the other. We represent over 300 pension plans consisting of more than 3 million plan members, with total assets under management in excess of $300 billion.

The ACPM promotes its vision for the development of a world leading retirement income system in Canada by championing the following Guiding Principles:

- Clarity in legislation, regulations and retirement income arrangements;
- Balanced consideration of other stakeholders' interests; and
- Excellence in governance and administration

Introduction

The ACPM appreciates the opportunity to again provide our input to the Government of Nova Scotia consultation process regarding the expansion of pension coverage and retirement income in Canada. We look forward to lending our expertise as third pillar pension providers to the Government of Canada and the provinces as you all move forward to meet the challenges that lie ahead for our retirement income system.

In this Brief you will find our perspective on the questions asked by the consultation process.

We are also attaching ACPM's 5-Point Plan; Improving Retirement Income Coverage in Canada which outlines our proposed solutions to expand and improve coverage in Canada.

Section I - The Right Answer to Improving Retirement Income Adequacy

The OECD uses a broad definition of retirement income to recognize that assessing adequacy should not just be about how much of a pension is being amassed, but should encompass all the saving, investment and living expense choices that most individuals experience throughout their working lives. For example, home ownership, children's education costs, transportation needs, investment plans, tax-assisted savings, along with daily living expenses, all influence how much and how an average person saves for retirement.

ACPM believes that the retirement income debate in Canada and proposals affecting pension plans and plan design need to reflect this reality.

The OECD has commented positively on our retirement income system and they and others have indicated that our so called Pillars One and Two – OAS, GIS and Canada Pension Plan/ Quebec Pension Plan (CPP/QPP) - provide a sound basis to build upon. This is not to say government programs cannot be improved upon when policy-makers deem it appropriate, but improving Canada's 'Third Pillar' – consisting primarily of workplace plans and individual savings – is, in our view, the most effective way to enable more Canadians to build greater retirement incomes. And we are confident that existing Pillar Three retirement income providers have a critical role to play in achieving that outcome.

Recently released studies commissioned by government provide support for our approach. Work done by Jack Mintz and by Bob Baldwin that describes the problem not as a crisis affecting the structure of the system, but as a targeted problem, reflects what ACPM has been saying. There are some Canadians in a variety of circumstances that need to save more, and there are others that want the opportunity to save more than they are otherwise permitted.

As a part of identifying solutions to these issues/challenges, we are concerned that many Canadians may think retirement income adequacy is beyond reach. The popular view in recent years has been that adequacy requires retirement income of at least 70% of pre-retirement earnings. But for any individual or family, adequacy is a question of expectations and, whatever the level of expectations, needs to consider the changes in costs from working years such as mortgage payments, work expenses etc., and the considerable amount of government support from tax reductions to living assistance that amount in effect to additional income for retirees. When one considers that 60% or even 50% could be a very adequate level of retirement income for many people, the goal is much more achievable. That is why we strongly urge that any solutions be accompanied by information on adequacy and we strongly support efforts aimed at increasing financial literacy of Canadians. For those Canadians for whom adequacy is truly beyond their means, for example those unable to participate in the labour force or who face other exigencies at some point in their lives, government support programs are likely the better answer than the contributory pension system.

Responding to the real issue will demand creativity, flexibility and communication and education to provide the range of options and the information necessary to encourage decisions by those who need or want to save more. There is no "one- size-fits-all" answer to an issue with roots in such varying circumstances. Canadians need a range of appropriate choices with differing contributory levels to reflect not only their individual situations, but their retirement expectations and needs.

In ACPM's view, proposals to expand CPP/QPP miss the point that the problem is a targeted problem. The CPP/QPP are universal programs ensuring a basic level of retirement income for all based on earnings. They function very well and will continue to do so into the future based on sound actuarial analyses of contributions from employers and employees. A 'one-size-fits-all' mandatory increase in payroll contributions to generate a one-size-fits-all increase in retirement savings for all workers, including those already saving sufficiently, would be the most costly approach that could be taken, and it wouldn't recognize that many Canadians prefer to use their income to save for retirement in other legitimate ways, such as paying down a mortgage.

We do think that encouraging more opportunities for group savings is the right approach and that Canadians need to have several choices to augment their retirement incomes. In that regard, we congratulate the Government of Canada and the provinces for having recognized the need for innovative pension designs as part of the announcement out of Charlottetown.

All retirement income programs have costs to run them. Lower costs come from economies of scale and efficient administration, and from the forces of innovation and product tailoring that competition brings to bear (whether DB, DC, Target Benefit or some other plan design). ACPM is firm in its conviction that, with the right policy and regulatory environment:

- employers can be encouraged to offer cost-effective pension plans and retirement savings vehicles that are adapted to their employees' needs; and

- retirement income providers can and do provide flexible options and the desired levels of customer service, at the same or even lower cost than could a supplemental CPP/QPP.

The C. D. Howe Institute has recognized that changes to the income tax system, and dealing with barriers to workplace pension plans, are where governments should put their focus. This echoes ACPM proposals advanced to a variety of forums. The list of proposed reforms noted in Section 2, details the proposals that ACPM thinks would have the most success in increasing retirement income coverage and adequacy in Canada.

Employer-sponsored retirement plans (whether DB, DC, Target Benefit or some other plan design) are, and must continue to be, part of the solution. Unfortunately, various issues have contributed to the decline in pension plan coverage, especially in the private sector (e.g. uncertain legal and regulatory environment, risk/reward mismatch in the DB system, negative impact of accounting standards, cost and complexity of plan administration, legal risks). Our country needs a vibrant system that encourages employers to offer pension plans to their employees, and other retirement savings vehicles as well. In particular, the current system needs urgent fixes in order to offer a positive environment for the implementation, maintenance and improvement of DB pension plans. The Canadian governments have an opportunity to work together in developing an environment where retirement plan coverage can increase but without posing a complex regulatory and administrative burden on plan sponsors and administrators. ACPM looks forward to participating in the building of this new regime.

A last comment is warranted on Registered Retirement Savings Plans. Our proposals include the option of enhancing RRSPs to allow parity regardless of the path a Canadian may choose to secure his/her retirement. This means a level playing field when it comes to the tax treatment of saving for retirement through RRSPs (and DC plans) versus DB plans. ACPM believes that RRSPs and TFSAs are important elements of the retirement income matrix as are other saving vehicles. In deciding whether such proposals are appropriate, we are confident that decision-makers will ensure that Canadians have a full and fair range of options to pursue.

Section 2 – Responding to Consultation Proposals

1. Enhancement of the existing Canada Pension Plan – modest, phased in and fully funded.

As mentioned in Section 1 above, the expert analysis concludes that the problem confronting us today is not a structural one with our system, but rather is a targeted one. There are some Canadians in a variety of circumstances that need to save more, and there are others that want the opportunity to save more than they are otherwise permitted. To accommodate the varying needs of Canadians, multiple options and opportunities must be presented. A one-size-fits-all solution misses the choice, flexibility and, of course, innovation which will be needed to meet today and tomorrow's requirements. Employers need to be able to offer cost-effective pension plans and retirement savings vehicles that meet the needs of their workforce. Canadians, especially those who do not enjoy the benefit of an employer-sponsored plan, need a range of appropriate choices with differing contributory levels to reflect not only their individual situations, but their retirement expectations and requirements.

ACPM believes our system should continue to strike the appropriate balance between individual, employer and government responsibility as found within our current three pillar system.

In ACPM's view, Pillars One and Two are currently performing as intended to provide a basic level of retirement income for all Canadians**.** This is supported by international assessments of Canada's retirement income system compared to other countries.

The critical role for increasing coverage lies with Pillar Three and, within that, the focus should be on encouraging and increasing access to group coverage opportunities. While individual saving options are an important part of the mix, the real opportunity for expanding coverage lies in making the benefits of scale and returns from employer-sponsored programs and group investing available to individuals in an innovative and flexible way, and revitalizing workplace dialogue and involvement. ACPM believes that Pillar Three provides the best mechanism for an appropriate and affordable approach for individuals, businesses, and government.

ACPM does not believe that the mandatory, 'one-size-fits-all' option of increasing CPP/QPP benefits is the right answer to a targeted problem. In addition to high cost and lack of flexibility, increasing Canada's universal defined benefit program has clear shortcomings.

The economic impacts of payroll taxes are well documented, and a proposal to increase such taxes is of concern, particularly given Canada's current economic circumstances and the need to stimulate job creation.

It is far from clear that the level of income that the CPP/QPP guarantees needs to be increased. Canada has been cited as a country that is doing a good job ensuring adequate retirement incomes for its lowest income groups. If there is a consensus that greater incomes are appropriate for low income seniors, then that should be achieved through OAS and/or GIS.

In fact, increasing the CPP/QPP could make many low income retirees no better off if they lose existing government supports such as GIS and various income-tested provincial supports. And if they have to make a higher contribution during their working lives at the expense of opportunities to, for instance, reduce household debts, they could be worse off.

Expanding CPP/QPP benefits also raises concerns about concentration risks in holdings of Canadian retirement assets.

However, should Governments choose, as you state, to enhance the CPP in a modest, phased and fully funded manner we would offer the following general comments and observations.

Given that the issue we face is a targeted one and not structural, ACPM would suggest a targeted solution, by adjusting the YMPE as it can more readily be made to address the cohort that is under-saving. Our preference would be that any changes to CPP/QPP involve the establishment of a second or ancillary plan thus ensuring that the existing CPP liabilities are not further exacerbated thereby making certain that there is no impact on accrued benefits.

Governments will also recognize that increasing CPP/QPP premiums will likely divert contributions away from existing DB/DC plans. This increase will make existing DB plans less efficient/more costly to operate. A further consequence may be the need to renegotiate fees on DC plans as they too are priced based on expected cash flow. This supports the premise that if there is to be an increase in CPP/QPP benefits, they should indeed be very modest. We would also draw to the attention of policy makers that any existing DB plans where benefits are integrated to the CPP/QPP will likely require long and difficult renegotiation if the benefit is affected and/or if the overall cost of labour to the employer is raised. On the latter point, and especially given the current state of the economic recovery, any adjustment to the CPP/QPP should be paid for by the employee and not the employer. Besides having the benefit of transparency by linking the payment with the beneficiary, it will not raise the cost of labour and thereby impact job growth.

Lastly, it is imperative that any adjustment to the CPP not affect existing or future RRSP contribution levels.

As noted in section 1 above, ACPM has spent considerable time studying options to increase coverage involving the Third Pillar as it represents the most efficient and effective way to provide Canadians with affordable coverage options. Below in Proposal 2, are our preferred solutions to the coverage issue.

2. Pension Innovation- Modernization of pension standards to improve flexibility in pension plan design.

For many years and on numerous occasions, the ACPM has argued for changes to the framework governing workplace pension plans (in particular, the simplification and harmonization of laws) in order to encourage the creation and growth of these plans. Key changes include revising pension legislation and guidelines to:

- for DB plans: implement permanent solutions to deal with the perceived risk/reward imbalance while encouraging increased benefit security (e.g. allow the use of special purpose "solvency accounts"), move pension plans from the broad trust law environment to a contract law regime, and allow more flexibility in plan design;

- for DC plans: allow a good faith standard of care or safe harbour in appropriate circumstances;

- for all plans: expand the definition of administrator and sponsor, remove requirements for similar benefits per class of plan members, and accept electronic communications.

These changes need to be accompanied by changes to the Income Tax Act (ITA) as well, including removing the primary purpose for pensions test, expanding the categories of eligible income, removing the minimum employer contribution, and expanding the criteria for multi-employer pension plan treatment.

As well, employment standards legislation needs to contemplate automatic enrolment, contribution deduction and escalation with opt-out to encourage increased workplace pension coverage.

As alluded to earlier, changes to the ITA are an integral part of the right approach to increasing coverage. These changes are not primarily about increasing existing incentives to save; rather they are about removing barriers to increased coverage, by providing maximum choice and an incentive to participate.

The ACPM believes that the greatest promise in increasing pension plan coverage and retirement income adequacy for Canadians can be achieved through a number of changes to the ITA and the various federal and provincial pension benefits legislation. In previous submissions and papers, ACPM made pension reform suggestions aimed at promoting increased coverage by employer-sponsored pension plans. Below, we provide you with a list of additional proposed reforms that we feel would be beneficial in achieving increased pension coverage for individuals who are not participating in an employer-sponsored plan.

Proposed Reform	Legislation	Rationale
Remove primary purpose for pension plans test	ITA	Allows coverage to continue post-employment
Expand the categories of income eligible for contribution to a pension plan	ITA	Allows for pension coverage for self- employed
Expand the annual contribution limits or create a lifetime contribution limit with a value comparable to the commuted value of public sector defined benefit pensions	ITA	Facilitates the growth of the income available in retirement
Allow plan members to deduct plan administrative expenses	ITA	To achieve parity with employer-sponsored plans
Remove minimum employer contribution requirements (unless the plan is mandatory)	ITA	Allows pension coverage even with impecunious employer
Expand the definition of "Administrator" to allow financial institutions not providing guaranteed benefits	Provincial/ Federal Pension Benefits Legislation	Allows aggregation of disparate groups to achieve benefits of scale
Expand the definition of entities that can sponsor a capital accumulation plan to include financial institutions	Guidelines for Capital Accumulation Plans	Allows aggregation of disparate groups to achieve benefits of scale

Proposed Reform	Legislation	Rationale
Allow administration of the plan to be on a "good faith" standard of care or make provision for a safe harbour, in appropriate circumstances	Provincial/ Federal Pension Benefits Legislation	Facilitates clarity of rules and risk management to achieve aggregation
National DC pension-specific legislation employing simplified minimum standards together with the Guidelines for Capital Accumulation Plans as a regulation	Provincial/ Federal Pension Benefits Legislation	To achieve a relevant and flexible legislative framework
Remove requirements for similar benefits per class of plan members	Provincial/ Federal Pension Benefits Legislation	Allows aggregation of disparate groups to achieve benefits of scale
Allow automatic enrolment with an opt-out	Certain Provincial Employment Standards Legislation	Increases potential of participation in the plan while still giving plan members the opportunity to say "no"
Allow automatic contribution escalation with an opt-out	Certain Provincial Employment Standards Legislation	Facilitates the growth of the income available in retirement
Enable electronic communications with opt-out	Provincial/ Federal Pension Benefits Legislation	Enables administrative ease and member awareness
Enable electronic beneficiary designations	Provincial/ Federal Pension Benefits Legislation and Provincial Insurance Legislation	Removes barriers to enrolment

ACPM believes that encouraging and supplementing existing retirement income opportunities is the right choice. More opportunities for employer-sponsored plans and for individuals both employed and self-employed, to participate in group coverage would be a cost-effective way to see significant increases in coverage (whether DB, DC, Target Benefit or some other plan design). Employers too would be attracted to the benefits of lower costs and increased access to multi-employer and other group options.

ACPM sees a role for "auto-enrolment with opt-out" as part of the right approach to encouraging increased workplace pension coverage. Experience in other international jurisdictions shows that it will produce increased coverage, without requiring those already satisfied with their savings, or who would best save in other fashions, to participate. It recognizes the workplace as being critical to achieving higher coverage. It allows employers and employees to participate jointly in a plan; it allows employees to participate in a group plan even if their employer chooses not to contribute and it allows employees not to participate even if the employer offers a plan. Those who are self-employed would also be eligible to join any plan. With barriers removed to enhanced group options, a number of large plans with varying features, involving benefits and contributions levels, would emerge targeting both those with little or no retirement savings and those that would like to augment their existing savings. Third Pillar providers would be expected to apply their expertise to ensuring employers understand these plans and their benefits and to encouraging employees to participate through, for example, auto-enrolment with opt-out. Similar to the experience in other jurisdictions, increased enrolment and coverage would occur, as more Canadians will think further about their retirement options.

ACPM believes strongly in choice. It is important that Canadians have the opportunity to build retirement income in ways that work best for them. We believe that a competitive marketplace will ensure that Canadians get the flexibility and choice they need at an affordable cost.

There has been considerable commentary lately on costs charged to managing and growing retirement savings vehicles. There are views about the cost of private sector services compared to those provided by the CPP, and the implication for supplemental coverage. It needs to be emphasized strongly and repeatedly that Third Pillar group retirement savings vehicles are priced competitively. Cost of service is lowered by economies of scale and competition, and it is increased as higher service levels are demanded by clients. This is the case regardless of whether those services are "publicly" or "privately" provided.

ACPM also appreciates the need for risk to be balanced with the importance of security of more adequate retirement incomes. That is one reason why we recommend that any provider of the new multi-employer plans need be entities with experience, expertise, capital and preferably subject to prudential and risk management oversight. Canada currently has many such entities that could fill this role. . The best way to find the right mix of risk and security is to offer Canadians several options through a number of providers, combine it with clear information, and allow for informed choice.

Large pension funds are required in order to gain maximum benefits from economies of scale. A single large plan only would see the benefits of economies of scale offset by the lack of competition and focus on customer service. Similarly, maximizing investment returns requires size but is also about offering services that match individual needs with investment opportunities. A number of large pan-Canadian plans would ensure economies of scale are accomplished while meeting the varied needs of Canadians. It also ensures that risk is appropriately diversified.

As a final comment we would encourage the Government of Nova Scotia to continue working with the Government of Canada and the other provinces for the sake of ensuring harmonization of legislation across Canada to the greatest extent possible.

We appreciate the opportunity to provide our comments and to elaborate on our position on the issue of coverage and adequacy. We would be pleased to make ourselves available to respond to any issue contained in our commentary.