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The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

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Innovation in Pension Coverage

A Framework for Institutional DC Plans

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FOREWORD

<u>The Association of Canadian Pension Management (ACPM)</u>

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 non-profit 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 400 pension plans consisting of more than 3 million plan members, with total assets under management in excess of $330 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

<u>Introduction</u>

The Problem:

Too few Canadians are saving for retirement through efficient, workplace pension vehicles. Too few employers are offering workplace savings vehicles due to reasons of cost, risk and complexity.

A Solution:

One part of the ACPM's Five Point Plan to address these issues is the establishment of a defined contribution pension plan (an "Institutional DC Plan") offered by a qualified institution or approved entity to employees of unrelated employers and the self-employed.

The Institutional DC Plan will be designed around the principles of simplicity, affordability for employees, respect for choice, economies of scale and risk pooling and a pan-Canadian legislative framework.

The Benefits:

In addition to providing employees and the self-employed currently not part of a workplace plan with an efficient, affordable means to save for retirement, the Institutional DC Plan leverages the best of behavioural economics to maximize both coverage and contribution amounts. It encourages more employers to participate by giving them a low cost, low risk alternative. It can be implemented on a national basis. It is supported by Canada's world leading financial sector.

1. <u>Legislative Framework for Institutional DC Plans</u>

The Concept

Employers decide whether to provide a plan and participating employers select an Institutional DC Plan to be offered to their employees. The employer provides information about its employees to Plan Provider (see definition that follows): thereafter its sole obligation is to remit employee and employer contributions in accordance with its commitment to its employees. Participating Employers (see definition below) may contribute on behalf of employees, but are not subject to a minimum contribution level.

Where an employer participates, its employees are automatically enrolled. Employees enrolled automatically may opt out of the Institutional DC Plan.

Members who do not opt out will be automatically set up to contribute 3% of gross employment income to the Institutional DC Plan; however Members (see definition that follows) can elect to contribute a lower or higher percentage amount.

The Institutional DC Plan would be permitted to provide for automatic annual Member contribution increases of 1% per year (with a maximum automatic contribution rate of 6%) subject to Member opt out.

Contributions by or on behalf of individual Members would remain subject to existing contribution limits under the *Income Tax Act*.

As well as employers, sponsorship could encompass unions, professional organizations, and business groups who work with existing Plan Providers to designate a plan aimed at their constituents. Such groups could also establish an Approved Entity to act as their Plan Provider. In these cases, the member would enroll directly with the Plan Provider and contributions would most likely be by monthly automatic withdrawal. Contribution rates and opting out would be the same for employees of participating employers, as would be the automatic provisions.

Self-employed individuals would be able to join these plans – in effect to sponsor themselves as an employee.

Automatic re-enrolment, and the consequent decision whether to opt out, should take place every three years.

Each member should have a common account identifier that would be used by all Institutional DC Plans in which they are enrolled, to avoid a multiplicity of small accounts.

Drafting Principles

The purpose of the retirement savings vehicle is to increase pension coverage among private sector employees and the self-employed. This vehicle is distinct from single employer and particularly multi-employer pension plans that are governed under existing pension benefits standards legislation. The framework does not contemplate mandatory participation by employers nor a minimum contribution by employers. This innovative vehicle could be pursued through new stand-alone legislation (preferably at the federal level) and/or as a new component under existing/amended/new pension standards legislation, as determined in each jurisdiction, so as to facilitate a harmonized, pan-Canadian adoption of the concept.

It is recommended that the purpose behind the creation of this plan be incorporated into the legislation in order to facilitate interpretation.

The legislation will make use of plain, permissive language and rely upon regulations and guidelines, as appropriate, all with a view to facilitating understanding and flexibility. It is recognized that other legislation and in particular the federal Income Tax Act, will require adjustments in order to enable this new retirement savings vehicle.

Definitions

- ***Institutional DC Plan*** – a retirement plan providing only Defined Contribution Benefits and made available by a Plan Provider to employees of related or unrelated employers and self-employed persons.

- ***Plan Provider*** – a Qualified Financial Institution or an Approved Entity.

- ***Employee*** – As per normal definitions.

- ***Employer*** – As per normal definitions.

- ***Self-employed Person*** - As per normal definitions.

- ***Defined Contribution Benefit*** – a pension benefit determined by reference to and provided by contributions and interest on the contributions, paid by or for the credit of a Member and determined on an individual account basis.

- ***Qualified Financial Institution*** – means a Schedule I Bank and a federally or provincially regulated life insurance company or trust company.

- ***Member*** – As per normal definitions.

- ***Pension Judgment Rule*** – a standard requiring a Plan Provider to operate the Institutional DC Plan in good faith, on an informed basis (including obtaining expert advice, where appropriate), in the interests of Members, and with appropriate processes to address conflicts of interests.

- ***Participating Employer*** – means an Employer required to remit contributions to an Institutional DC Plan.

- ***Approved Entity*** – an entity subject to a licensing regime that ensures prudence, proficiency and the security of plan assets, which may include pension societies, not-for-profit organizations and/or public administrators established for the purpose of acting as a Plan Provider.

Registration, Administration and Governance

Plan Provider to file with relevant authority;

(a) Institutional DC Plan text that meets minimum prescribed criteria;
(b) Details of the arrangement for holding assets;
(c) Internal governance by laws; and
(d) Any other prescribed material.

Relevant authority to register Institutional DC Plan.

Plan Provider to file prescribed plan information on an annual basis.

Plan Provider to operate the Institutional DC Plan in accordance with the Pension Judgment Rule, the terms of the Institutional DC Plan and the internal governance by laws. Further protection of member benefits is afforded by the prudentially regulated nature of certain Plan Providers. For those Approved Entities that are not prudentially regulated, an independent review committee or other similar body made available by the Entity, may be required to oversee Plan operations.

Investment

Each Institutional DC Plan would, subject to minimum requirements to be set out in regulations (see below), determine if Members would be provided with investment choice and, if so, the investment options to be made available.

Disclosure of Information

Member to receive at least annual statement of account. All communications between the Plan Provider and Members, including the designation of beneficiaries, may be electronic unless the Member indicates otherwise.

Members to be notified of all Plan amendments within 60 days of their adoption.

Plan and investment option information along with decision-making tools to be made available by Plan Provider in accordance with the CAP Guidelines. [The Guidelines may need adjustments in order to accommodate Institutional DC Plans.]

Vesting and Termination

Members are immediately entitled to all Participating Employer contributions.

Members may move their account balance to another Institutional DC Plan or registered pension plan upon termination of employment.

Participating Employer may stop contributing to an Institutional DC Plan at any time or may start contributing on behalf of its employees to an alternative Institutional DC Plan.

The Institutional DC Plan may provide for annuitization (internally or externally) of portions of the Member's account balance over the course of the accumulation period, to protect against future market downturns and minimize retirement date sensitivity risk.

Upon retirement at age 55 or later, Members may convert their account balance to a retirement income stream. Members must begin to receive retirement income based on their accumulated account balance by a prescribed age.

Members may convert their account balances to a retirement income stream through purchase of a life annuity, another retirement income vehicle or, if the Institutional DC Plan so provides, a retirement income stream paid from the Institutional DC Plan itself (internal annuitization).

Locking-In

Members may withdraw funds only for reasons of terminal illness or non-residency, except where legislation specifically provides otherwise. Phased retirement arrangements would also be permitted based on existing rules.

Member account balances are exempt from execution or seizure.

Winding Up

Plan Provider may wind up an Institutional DC Plan. In such event, Members must be given written notice describing their rights to transfer to another Institutional DC Plan or registered pension plan without penalty.

The regulatory authority may order the wind up of an Institutional DC Plan in the event of the insolvency of the Plan Provider.

Regulations

- Minimum plan criteria such as qualified default investment options, maximum number of investment options for base plan, allowable fee types
- Criteria for Approved Entities
- Criteria for permitted fund holding arrangements
- Content of annual reporting
- Reference to CAP Guidelines
- Content of internal by-laws
- Maximum age at which account balance must be converted to retirement income

2. <u>Institutional DC Plans in Practice</u>

Attracting Employers

Employers need to be educated as to the benefits of providing a low cost retirement savings vehicle to their employees. In addition to the obvious social advantages of having financially self-sufficient retirees, an employer who demonstrates a commitment to this aspect of their employees' financial well being gains enormous good will along with a competitive advantage within an ever shrinking skilled labour force.

To acquaint employers with the benefits of providing a low cost retirement savings vehicle to their employees and educate them as to how they could work for them, the Qualified Financial Institutions and Approved Entities would launch marketing strategies to employers and other potential sponsors (unions, professional organizations and business groups). A good example of such communication may be found at http://www.kiwisaver.govt.nz/. New Zealand has recently launched the KiwiSaver Plan and this comprehensive website provides potential contributors with information about the plan, its administrative processes, benefits, etc.

The prevalence of health insurance plans among all employers, including those without pension arrangements, illustrates the ability of certain Plan Providers to reach a broad target audience and attract employers to provide coverage. The Canadian Life & Health Insurance Association estimates about 90% of Canadian employees receive life and health insurance coverage from their workplace. This compares to 50% coverage in the workplace for retirement savings plans.

Another good example of reaching target audiences in Canada is the success of CARP who have built a network of available services (various types of insurance, home services such as moving providers, car rentals, etc.)

The Internet is only one tool that could be used effectively to promote Institutional DC Plans. Trade magazines for associations, unions and other professional organizations may also be a potential source of marketing for these plans.

Informing Employees

Employees will be made aware of the plan through their employer with the overall assistance from the Qualified Financial Institution or Approved Entity. These providers are experienced in communicating with individuals, ensuring they understand the administrative processes (joining the plan, selecting their investment option(s), etc.), the advantages of saving for retirement, assisting with the individual's investment choice and ensuring they are kept up to date with the activity in their accounts.

For individuals who are not connected to an employer (the self-employed, unions, professional associations, etc.), the Qualified Financial Institutions or Approved Entities would "advertise" their Institutional DC Plan through various media including written communication, web based and audio (radio for example).

The expertise that the Qualified Financial Institutions and Approved Entities demonstrate with existing health and welfare plans is easily transferred to dealing with individuals in Institutional DC Plans, as the infrastructure (communication capabilities, etc.) already exists. Some groups, such as industry or professional associations and unions, also provide such coverage to their members, and could adapt their structures to the Institutional DC Plan context.

It is in the best business interest of the Qualified Financial Institutions and Approved Entities to attract as many participants to their plan as possible. This will allow them to utilize economies of scale and remain competitive both from a service and a fee perspective.