

Access to Locked-in Accounts

Response to Alberta Finance Discussion Paper

By

Alberta Council

Of the

Association of Canadian Pension Management

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Introduction

The Association of Canadian Pension Management (ACPM) works on behalf of over three million pension plan members across Canada. We are a national association with membership from over 400 pension plan sponsors and related stakeholders. The ACPM is dedicated to the growth and health of the retirement system in Canada. Our advocacy activities are based on the following three principles:

- Clarity in pension legislation, regulation and arrangements
- Good governance and administration, and
- Balanced consideration of stakeholder interests

In mid-2002, the Alberta Council of ACPM was formed to work closely with Alberta plan sponsors and members and promote these three principles to Alberta stakeholders.

We are encouraged with the initiatives that Alberta Finance has taken to date, specifically efforts made to harmonize and streamline pension legislation and the current consultation process, which includes the following discussion papers:

- Strengthening risk management, disclosure and accountability;
- Pension Division on Marriage Breakdown; and
- Access to Locked-in Accounts.

ACPM welcomes the opportunity to participate in this consultation process and the Alberta Council is pleased to submit this response dealing with access to locked-in accounts.

General Comments

We believe that the timing is right for the Alberta Government to revisit the question of locking-in and to consider a major change relative to the current locking-in rules. We also believe that Alberta faces a huge challenge in making such changes. The unlocking question has been raised with the ACPM membership at our national conference in September 2003, with the 25-member Advocacy and Government Relations Committee and with the much smaller Alberta Council of ACPM. There is simply no consensus and in fact, members have diverging views resulting in an almost even split between those who favour complete un-locking and those who believe locking-in is vital to the continued health of the Canadian retirement system. If these pension professionals have such divergent views, your task is indeed a challenge!

There are several points we would make. In doing so we are making these assumptions: unlocking while in employment with the plan sponsor is not under consideration and; our definition of unlocking is not to be confused with phased retirement objectives. Unlocking is specifically where an individual has complete control over access to amounts, without restriction, not so they have greater flexibility prior to age 65 to achieve coordination with government benefits.

Administration of Locking-in has become complex

Pension regulators and financial institutions have created a very complex system to ensure locking-in and to administer locked-in retirement accounts. Is this complexity practical or even necessary to protect the retirement savings of the minority of citizens that are members of registered pension plans? We note the following regarding the evolution of this system:

The mobility of employees, and the restructuring of employers, have both resulted in a proliferation of locked-in retirement accounts in Canada. As more employees move freely from employer to employer, no longer expecting to work for the same organization throughout their career, the numbers of locked-in accounts will increase. At the same time, the increase in RRSP contribution limits, increased discussion in the popular media about retirement savings needs, and an expansion of the financial planning market have all contributed toward an increase in the number of individuals with personal retirement savings plans. Employees lose track of the difference between their locked-in retirement accounts and their regular RRSPs and financial institutions have inadvertently unlocked funds that should have remained in a locked-in account.

Alberta has determined funds can be unlocked in certain cases, including financial hardship. This has led to another level of bureaucracy where tax dollars are required to pay the personnel and infrastructure costs of managing these exceptions to locking-in rules. As the availability of this option becomes wider known, the costs are very likely to increase.

A Total Compensation Perspective

Regardless of whether an employee participates in a pension plan or not, all Albertans must recognize and understand the component of their annual total compensation that is being allocated toward their retirement income. For those participating in a defined contribution plan, that component is very clear. It is an ongoing challenge of plan sponsors to ensure that defined benefit plan members understand the value of this component of their compensation package. For citizens who are not members of a pension plan, a portion of their compensation will also be required to fund their retirement years. As indicated above, there is a growing awareness of personal responsibility to plan for retirement, just as there is personal responsibility for meeting other financial obligations. Employees have diverse needs, priorities and values that change over their working lifetimes and want the flexibility to make choices that fit their needs and priorities. We believe it is appropriate to ask: Should the policies of government and former employers interfere with Albertans' ability to make choices about their personal financial circumstances?

Employees have the ability to choose how they spend the great majority of their salary. They enter into financial contracts and purchase homes whose value may far exceed that of their retirement savings. However it is that one piece of their total compensation that we regulate, forgetting, so it seems, that most of these people are able to well manage the other financial decisions in their life.

Individual choice vs. the employment contract

The discussion paper indicates that approximately two-third of Albertans do not participate in registered pension plans and are therefore responsible to determine their own needs with respect to retirement income security beyond that provided by government programs. We believe the overwhelming majority of Albertans can make informed decisions about their personal financial circumstances. We think it is appropriate to ask: is there a broad public policy benefit associated with a polity that affects such a small percentage of Albertans?

Portability at termination of employment converts the pension promise to a lump sum amount representing the deferred compensation accrued during the period of plan participation. The result is little different from the savings accumulated out of current compensation in a personal RRSP. The former pension plan member is at a disadvantage relative to other non-member individuals for whom the savings pattern is less restrictive. A non-member individual can adjust their savings patterns and access previously allocated retirement savings in response to changing circumstances in their lives (“life-cycle” needs of marriage, home ownership, children, eldercare).

However, the former plan member accepted the arrangement with the plan sponsor who had dedicated compensation for specific use in retirement, as part of the employment contract and cannot make choices regarding his retirement savings.

The Discussion Paper suggests that locking-in resulted from the reactions of employers and unions in response to the portability requirements of pension reform in the 1980s. Plan sponsors have come to fully support portability. Many sponsors continue to have a strong opinion about the preservation of locking-in of retirement accounts for their intended purpose. However, as pension plans have evolved and a shift toward more employee self-determination is evident, many plan sponsors may not object to a loosening of the locking-in rules.

Strain on the Social Welfare System

Some stakeholders contend that access to retirement accounts for uses other than retirement will ultimately put a strain on the social welfare system. With the increased focus on retirement savings in society, it is expected that this strain would only result from those who were truly disadvantaged or irresponsible.

Many individuals now seeking access to their retirement accounts for financial hardship reasons might do so solely to avoid having to access current welfare programs. The funds accessed may serve a useful purpose in supporting the recovery of these individuals whereby they do not rely on the social system.

For the most disadvantaged or irresponsible individuals who seek access to their retirement accounts, such funds will reduce the shorter-term burden on social welfare and serve to provide an outside chance for recovery. It is likely these individuals would rely on the social system in any case. We believe it is unreasonable to assume that the small

cohort of individuals who might be persistent users of social welfare programs and will unlock funds from their locked-in accounts (if permitted) will make a material impact on Alberta's social welfare programs. Stated another way, we believe it's appropriate for government to ask: is the cost of locking-in a justifiable public policy?

Is there not a greater risk to the social security system from those who do not participate in pension plans? If locking-in is integral to the strengthening of Canada's social security programs, then perhaps it should be extended to all retirement savings – an idea that may be considered inappropriate in many circles.

The increased focus on savings for retirement has resulted in individuals taking responsible steps to plan for their retirement with both locked-in and non-locked-in retirement accounts. Unlocking all retirement accounts would likely not change the behaviour of the majority of Albertans.

Employers and unions are less inclined to sponsor pension plans if locking-in after termination of employment were removed

The Discussion Paper indicates that locking-in was introduced in the mid-1980s in response to employer and union reaction to the portability requirements of pension reform. As such, locking-in is not a corner stone for the establishment of pension plans. In fact, pension reform protected many employees from the loss of employer-provided benefits upon termination of employment. Previously, mobile employees may have only gained access to their own contributions, if any.

The choice to sponsor a registered pension plan or a group RRSP will ultimately depend on the competitive need to attract and retain effective employees and the plan sponsors' approach to the risk involved in providing retirement income to employees, and former employees.

General Recommendation

There are two overriding concerns at the root of the locking-in discussion:

- Former plan members with locked-in accounts are generally not responsible enough to manage this potential “windfall”, will spend the money and will eventually rely on the public purse to fund their retirement. People may even choose to leave an employer in order to access pension funds.
- Companies and unions will not continue to sponsor pension plans where former employees have immediate access to these accounts and may use them for purposes other than retirement savings.

As stated, Alberta is correct in addressing the issue of locking-in. However we believe the questions posed cannot be answered entirely by the pension regulators in Alberta. Rather, this is a question that should be discussed at a national level, with all provinces participating and in the context of the social welfare system. In addition plan sponsors must be invited to the table to answer the second question posted above - will they continue to sponsor pension plans given the possibility of un-locking.

This discussion should take place over the next two years and a conclusion reached. If, despite best efforts, a uniform position cannot be formed, your office should then determine the direction best suited for Albertans.

In the meantime, we understand that Alberta needs to make decisions to manage shorter-term concerns. We offer the following:

Proposal I – no change

We do not support this proposal.

- The current system for locking-in is overly complex and difficult to understand by both plan members and financial institutions.
- Pressure will continue to be placed on our elected representatives by individual constituents.
- Individual choice is not considered at a time when for many, it is becoming increasingly important.

Proposal II – Minor Impact on current locking-in rules

Combine LIF and LRIF maximum withdrawal amounts/Introduce a new LIF product.

We do not support these proposals.

- These address the needs of only individuals who are in receipt of income out of their locked-in funds.
- Adds to an already overly complex system.
- Does not address the bigger issue of locking-in.

Permit Mortgage Investment

If we continue to require locking-in, this investment alternative is worthy of consideration. There is debate over whether this alternative is in the best interest of the holder of the retirement account. Alberta Finance should consider the risks associated with sanctioning this investment option.

Proposal III – Moderate Impact on current locking-in rules

These proposals fail to address the bigger issue of locking in such as the administrative complexities, pressure from Albertans to access locked-in funds and asking the pension regulator to determine who is eligible to access locked-in funds.

If we determine locking-in is appropriate we have the following comments

Raise “small amount” limit

We suggest that the small amount limit be applied uniformly across all ages on the basis that the age-discrimination is not warranted and the 40% threshold does not serve to protect a materially substantial amount of retirement savings.

Exempt employees' contributions from locking-in

This proposal is worthy of consideration as it permits a higher proportion of a former employee's pension value to be unlocked at younger ages, thus having a better fit with the deemed life-cycle needs of Albertans.

Continue financial hardship withdrawals

The financial hardship exception should continue. However the most viable method for administering this exception is to create hardship rules based on a formula, as has been done in Quebec.

Permit one-time partial withdrawal

This proposal would simplify administration of the access to locked-in funds and the amounts accessed could in many cases be substantial which may provide assistance in financial hardship circumstances. We question whether the initial distribution to accommodate both a locked-in and a non-locked in account would be the responsibility of the plan sponsor. Also, how will the appropriate locked vs. un-locked ratio be determined?

Permit withdrawals from pension plans for non-residents

As a minimum, this proposal should be considered.

Extended provisions permitting withdrawals from pension plans for shortened life expectancy.

We agree in principle with this proposal but suggest that guidance be provided as to what constitutes shortened life expectancy. We believe the proposal should be revised so that unlocking for members who are eligible for retirement at the time the request is made, not be a requirement under the Act, but be an option permitted under a pension plan.

Proposal IV - Major impact on the current locking-in rules

Introduce creditor-protected RRIFs.

This proposal should be extended to cover the full array of retirement accounts rather than only retirement income funds. It could also be a partial solution, i.e. lock the funds in until retirement and then provide flexibility.

Discontinue locked-in accounts, but remove the "portability" requirement for registered plans

We assume this to be a plan sponsor choice: the sponsor can remove portability, keep the pension intact until retirement and then provide a retirement income OR the plan member will be allowed to withdraw the pension value and the funds will not be locked-in.

We support this proposal as it allows the plan sponsor to make the choice, respects the employment contract, locks in the pension promise and if the portability option is extended to plan members provides a total compensation perspective and respects the employee's ability to choose.

Discontinue locking-in

We reiterate that this is a major decision that should not be taken hastily nor made outside of the context of the social welfare system.

Additional Proposal

Continue portability but provide regulatory support for locking-in at the option of the plan sponsor

This option is worthy of consideration but does not address all the issues relating to the access of locked-in retirement accounts. This proposal maintains portability as a required provision of pension plans since it is a widely accepted and valuable benefit for mobile employees. However, to respect the employment contract, this option would permit a plan, as an option, to require that the amount transferred be locked-in for retirement income purposes. Revised or existing minimum standards for locking-in could become plan provisions to which financial institutions must abide. Regulations supporting the plan sponsor's choice in this regard would be necessary.

This option has the following advantages.

- It permits the plan sponsors to enforce the employment contract with respect to its benefits.
- It permits those employers who embrace employee self-determination to exercise that option.
- It removes the regulatory intervention necessary to accommodate exceptions to locking-in.

However the following disadvantages are noted:

- Locking-in administrative complexity would not be avoided and may actually be increased.
 - A larger array of restrictions might apply to locked-in accounts.
 - Financial institutions may be inclined not to offer these locked-in savings vehicles.
 - No controls over the financial institutions that may offer locked-in savings vehicles.

It is expected that this approach may eventually lead to full unlocking as plan sponsors recognize the administrative complexity to administer locking-in on their own. Respect for the employment contract would be eroded.