



Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

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Pension Policy Branch
Ministry of Finance
5th Floor, Frost Building South
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Toronto Ontario
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Via email: pension.feedback@ontario.ca

To Whom It May Concern:

Re: Proposed Pension Benefits Act Regulation 909: Pension Payments from Pension Plans which Provide Defined Contribution Benefits

This letter is PIAC's response to the request from the Ontario Ministry of Finance for comments on the Proposed Amendment to Regulation 909 under the Pension Benefits Act - Direct Payments from Pension Plans which provide Defined Contribution Benefits. PIAC welcomes the opportunity to comment on an important development affecting defined contribution pension plans, as a growing proportion of its members sponsor defined contribution ("DC") pension plans.

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over \$1 trillion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

OVERVIEW & CURRENT ENVIRONMENT

The proposal to allow DC pension plans to make pension payments directly to plan members is a very positive development in the evolution of DC pension legislation.

The current regulatory environment makes it extremely challenging for a non-financial institution, such as a DC pension plan to offer LIF or RIF type products. PIAC is aware of an Ontario DC plan, which is a PIAC member, that offers a group retirement income fund

(RIF) to its plan members. Although the benefits were immediate - lower management expense ratio relative to the retail environment, easier transition for unsophisticated retiring plan members, and greater asset retention by the plans, which improved the level of fees for all participants - the administrative complexity in setting up the RIF was high.

Some of the difficulties caused by the current regulatory environment as they pertain to the DC plan offering the RIF include:

- Some types of investments are not considered qualified investments by the Canada Revenue Agency and are therefore not admissible for the RIF. The equity and debt of companies not listed on a Designated Stock Exchange are not qualified investments. A Designated Stock Exchange is a stock exchange, or a part of a stock exchange, that has been designated as such by the Minister of Finance¹. As a result, investments in emerging markets debt and equity are not allowed, as most emerging markets stock exchanges are not Designated Stock Exchanges. Many of the diversified investment options offered by DC pension plans invest in emerging markets debt and equity for return enhancement and diversification purposes. Removing such options from the RIF leads to a sub-optimal plan lineup. Leveraging a similar investment line-up across both the DC Plan and the RIF is important for gaining the economies of scale advantages.
- The DC Plan is not considered a “permitted client” by the Ontario Securities Commission when RIF assets are taken into account. This prevents the DC Plan from hiring quality foreign investment managers as many of these managers rely on the OSC’s exemption for foreign investment managers to manage money in Canada for institutional investors.
- As the pension plan is not considered a financial institution, the sponsor must hire a financial institution to act as its agent to make payments to members, with the additional costs associated with these services.

Allowing payments from the DC pension plan will mean that a RIF will no longer be required and the major current regulatory issues related to making payments to former employees will be addressed.

In addition, further benefits would be created:

- Management expense ratios incurred by DC plan members are generally and often significantly lower than in the retail market. Remaining in the plan could improve fees and increase the net income received by pensioners over their retirement.
- The DC pension plans would be able to retain more assets, which generates two additional benefits: (i) with the step-down fee schedules used in the investment management industry, a larger asset base would translate into even lower fees; and (ii) DC pension plans would face smaller and more predictable disbursements when members retire, as more plan members would remain in the plans. This would support the investment in longer-horizon illiquid assets, such as private equity, infrastructure, real estate, private debt, etc., which could improve the risk / return profile of the fund.
- Plan members, who are often less financially literate than we all hope, would not need to seek a financial institution to administer their assets post-retirement. Member’s

¹ Source: Canada Revenue Agency

familiarity with the plan sponsor's current program could reduce their anxiety as they approach retirement.

The current regulatory issues facing the DC Plan referred to above that set up the RIF have contributed to a reduced popularity of the program among plan members. Recent data shows that the percentage of plan members reaching normal retirement age who chose to transfer their assets into the RIF, is down to the low teens. By contrast, a British Columbia plan sponsor which offers pension payments directly from its DC pension plan - as these are allowed in their province - retains on average 67% of its members in its plan once they retire (based on the past five-year average). PIAC believes that allowing pension payments from Ontario DC plans will boost participation rates as it would allow for members to seamlessly transition into an account with identical investment options.

PIAC agrees with the proposed regulation that the change to allow pension payments from a DC pension plan be voluntary. The sponsor would have the choice to offer pension payments from the plan, and as a result of this choice, members would have the choice to take their balance out of the plan or leave it in. The plan sponsor would expect to incur higher administrative costs to manage a larger number of participants, including aging participants, and to manage the additional regulatory requirements, which are downsides to the potential benefits outlined above. Should the plan sponsor offer the option of pension payment from the plan, the DC member/pensioner should retain the choice to continue participation, in whole or in part, as they own the assets and they retain the investment risk.

Enclosed are PIAC's responses to each of your posed questions. In addition, we have provided specific comments on select aspects of the proposed regulations for your consideration.

Finally, PIAC would encourage harmonization across all provinces and encourage the Ontario regulators to work with peers across the country. This would facilitate portability across employer plans reflecting a mobile labour force; and this would reduce the administrative complexity, keep fees lower and the payments to the ultimate pensioner higher.

Thank you again for this opportunity to comment on the proposed Regulation. We would be pleased to discuss any aspect of this letter in further detail at your convenience.

Yours sincerely,



Michael Keenan
Chair

QUESTIONS FOR STAKEHOLDERS

The Ontario Ministry of Finance asked four questions to stakeholders in its proposed regulation documents.

Should participants be able to transfer funds into a variable benefit account from other locked-in sources? Why or why not?

Yes, PIAC would support this change.

It is PIAC's view that portability is important for a variable benefit account. With plan members expected to change jobs several times during their career, having the opportunity to consolidate all of their retirement assets into a single plan would facilitate the management of the account and possibly lead to lower management fees for all participants.

However, once a participant's assets are transferred out of the DC pension plan, they should not be allowed to return unless specifically allowed by the individual sponsor's plan text. This is to minimize imposed administrative responsibilities and complexities for plan sponsors.

Should participants be able to transfer funds from a variable benefit account to other retirement income vehicles (e.g. Life Income Fund, annuity purchase)? Why or why not?

Yes, PIAC would support this change.

Again, portability and flexibility are important features to have. Should members' personal situations change over the years, they should have the option to transfer their retirement assets.

In addition, the financial literature suggests that a life annuity is part of an optimal retirement portfolio: "In conclusion, more than 50 articles discuss the optimal timing of annuitization, and although authors, papers, and models provide different conclusions, the main result seems to be that at some advanced age—perhaps as early as 60 or as late as 80—most consumers should have some of their wealth in life annuities²."

This is especially true for households that are not covered by a defined benefit pension plan. It is crucial for them to protect themselves against longevity risk, which can be easily achieved by purchasing a life annuity.

Should participants be able to unlock up to 50% of funds initially in a variable benefit account? Why or why not?

² Molevsky, Moshe A., "Life Annuities: An Optimal Product for Retirement Income", Research Foundation of CFA Institute, 2013.

Given that this feature is available for Life Income Funds, in order to have consistency, it makes sense that the variable benefit account also has that feature.

Would providing any or all these options involve significant administrative resources?

We do not think so. Plan sponsors already have staff or administrators that assist with member enrollment and retirements. Allowing members to move money into or out of the plan could be accommodated by existing staff or administrators, however excessive transfers should be discouraged.

COMMENTS ON THE PROPOSED REGULATION

1. Eligible Plan

The proposed regulation states: "In order to offer a variable benefit account, the terms of the pension plan must allow for this option."

PIAC supports the view that the option to offer pension payments directly from a defined contribution pension plan should be voluntary on the part of the plan sponsor.

2. Eligible Participants

The proposed regulation states: "... an eligible participant would be a member or former member in respect of that plan, as defined in section 1.1 of the PBA".

PIAC supports a definition of eligible participants that is fair and minimizes the administrative complexity to the plan. For example, PIAC supports the proposed definition in that it prohibits spouses from joining the plan. However, the inclusion of former members can create undue administration. PIAC would consider it reasonable for returning members to be eligible only if the sponsor allows for this in the plan text.

3. Eligible Accounts

PIAC supports the proposed regulation regarding eligible accounts.

4. Assets in Variable Benefit Account

The proposed regulation states: "... the entire amount contained in the DC account owned by the participant must be transferred into the variable benefit account, if an eligible participant elects this option."

PIAC supports this requirement as it relates to partial settlement of the current DC account holdings, as there is no reason for the members to leave money in the defined contribution pension plan. However, PIAC does *not* support this requirement as it relates to transferring 100% of a plan member's DC account to a single variable benefit account. Plan members should be afforded the option whereby they are permitted to settle their DC account by transferring a portion of DC plan assets to the VBA and a portion to other approved vehicle(s).

5. Periodic Payments out of the Account

The proposed regulation states: "...The participant would be required to notify the plan administrator of the amount and frequency of payments from the variable benefit account each year. If the participant does not do so, the minimum amount prescribed for a RRIF under the Income Tax Act would be paid."

PIAC supports most of the elements contained in the proposed regulation regarding Periodic Payments out of the Account. However, PIAC does *not* believe that members should be able to dictate the frequency of payments from the variable benefit account. This decision should be left to the plan sponsor as offering several payment frequencies would increase the administrative complexity of the plan and make it more difficult for the plan sponsor to offer the variable benefit account at low cost.

6. Maximum Amount

The proposed regulation states: "The maximum withdrawals amounts would mirror those contained in the LIF provisions."

PIAC supports this view as it brings consistency among the retirement products available.

7. Minimum Amount

The proposed regulation states: "The amount paid out of the account during the fiscal year would not be permitted to be less than the minimum amount prescribed for a RRIF under the Income Tax Act (Canada)."

As with the Maximum Amount, PIAC supports this view as it brings consistency among the retirement products available.

8. Withdrawals based on Shortened Life Expectancy

The proposed regulation states: "Subject to the terms of the pension plan, a variable benefit account participant would be able to, upon application in accordance with the requirements below, withdraw all or part of the money in the account if, when the participant signs the application, he or she has an illness or physical disability that is likely to shorten his or her life expectancy to less than two years."

PIAC support this regulation as it is a sensible and reasonable accommodation to help plan members facing a shortened life expectancy. However, given the unique and stressful situation, additional safeguards should be provided to the surviving spouse by requiring the advice of independent legal counsel before waiving his or her entitlement to a survivor pension.

9. Annual Statements

PIAC supports this regulation as the information required to be included in annual statements is necessary for members to properly manage their account.

10. Survivor's Benefits

PIAC supports this regulation as it is consistent with the survivor's benefit regulation related to LIF and RRIF arrangements.

11. Specified Beneficiaries

The proposed regulation states: "Subject to the terms of the plan, a variable benefit account participant would be able to designate a Specified Beneficiary in accordance with subsection 8506 (8) of the Income Tax Regulation (Canada). If a Specified Beneficiary has been designated by the participant, this person would be permitted to elect to receive a schedule of income payments, instead of a lump sum."

PIAC supports this regulation as it is reasonable.

12. Statement on Death of Participants

PIAC supports this regulation as it is reasonable.