



Pension Investment  
Association of Canada

Association canadienne des  
gestionnaires de caisses de retraite

March 31, 2011

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Via email - Lynn.Hemmings@fin.gc.ca

Dear Ms. Hemmings,

**RE: Consultation on Pooled Registered Pension Plans (“PRPP”)**

This submission is made by the Pension Investment Association of Canada (“PIAC”) in reply to the request for comments to the list of key questions released to stakeholders on February 8, 2011.

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 \$940 billion 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.

Thank you for the opportunity to participate in the industry consultation on this important initiative. We are pleased to set out in the attached document (Appendix A) our responses to relevant consultation questions, which are those that are central to our members' experience as administrators of large pension funds. We will also address the questions in the email follow up from Dan Calof of the Department of Finance that we received from you on March 8 (Appendix B).

PIAC is well positioned to provide a unique perspective on PRPPs as our members are administrators of large pension funds and often are part of organizations with large groups of employees. In preparing these comments we have considered the best interests of those Canadians not in pension plans. We expect that most of our members are unlikely to consider the use of PRPPs themselves; however we can provide perspective on our plan members and how they respond to pension plan features whether defined benefit or defined contribution.

We strongly encourage the government and Minister Menzies to pursue the commitment to proceed with PRPPs, which address the critical need for added pension coverage in Canada. We would be pleased to meet with the Department of Finance again if it would be helpful to explore these issues further.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Barbara Miazga', with a stylized flourish extending to the right.

Barbara Miazga  
Chair

## Appendix A

March 31, 2011

### Pooled Registered Pension Plans – PIAC Responses to Questions for Stakeholders

#### Investments and Costs of Investments

1. How should the framework address the number of investment choices offered by an administrator?

- What would be an optimal number of investment choices that an administrator should offer? What types of funds should be offered at a minimum (i.e. type of assets in the funds)?

Answer: PIAC's view is that there is no specific optimal number but that there should be as few options as possible to maintain the low cost model and to allow simplicity for effective communication with participants. Simplicity and effective communication are both important elements to achieve in the PRPP system, because we believe that most PRPP members will be unsophisticated in terms of investment experience and knowledge. For example, some basic fund options are: Money-Market/GIC, Balanced Target Risk (conservative, moderate and growth) or Balanced Target Date.

The selection of an appropriate default option is the key decision. Because for most individuals inertia prevails when faced with the selection of investment options and because most unengaged members need to be protected from poor asset allocation decisions, life cycle based options such as target date funds could be used as the default.

- How should this optimal number be determined (e.g., by the administrator? Prescribed in regulation?)

Answer: The administrator should determine this. The optimal number should not be prescribed by the regulator as there is no optimal number. However, the cost paradigm could be prescribed. Cost limits would likely lead to constraint in the design and selection of options.

2. According to the Framework Document, PRPPS are large pools of capital with "low costs"

- What should be included in the definition of costs? Can these costs be disaggregated on a comparable basis?

Answer: Investment Management, Operating - Investment (custody, brokerage trade commissions, legal, tax), Admin - Non-Investment (disclosure, communication, modelling tools, distribution). These costs should and must be disaggregated to ensure that the costs are fully transparent to the participants.

- What are the drivers of cost?

Answer: Passive versus active strategies, the size of fund, the complexity and number of investment options, the degree of active management, the asset classes, the market, and the number and level of services provided are all drivers of costs.

- How does the provision and cost of investment/financial advice to plan members fit into the costs?

Answer: We believe that modelling tools and financial education should be included, but advice should be provided outside of PRPP's to minimize costs and ensure no conflicts exist – real or perceived.

- Should “low cost” (i.e. as it relates to the PRPPs in general) be defined in the framework?

Answer: Yes.

- Is there a particular threshold at which a cost is no longer low?

Answer: PIAC believes that if the cost for a particular strategy (defined by the relevant asset class, degree of active management, and mandate) is more than the institutional median for such a strategy it is no longer “low cost”.

- Should there be a limit on fees for the low cost investment option?

Answer: Aggregate cost limits should be established for low cost investment option.

3. The framework document notes that the investment options should specifically include “a low cost option.”

- In this context, how should “low cost” be defined in the framework? Should there be a fee limit?

Answer: PIAC defines low cost in this context as the institutional median for the strategy in question and that there should be a cost limit for the low-cost option.

- How should this low cost be operationalized (e.g. rules-based approach? principles-based approach)?

Answer: PIAC supports a principles based approach that is fully transparent, and not to exceed the target median costs as per relevant institutional benchmarks. Appropriate benchmarks can be sourced through national pension investment consulting firms.

- What are the 3 lowest-cost actively-managed and 3 lowest cost passively-managed funds you offer? How do you demonstrate the value of higher cost funds?

Answer: Higher cost funds tend to be in less liquid markets (such as emerging markets) and asset classes (such as infrastructure) and have a higher degree of active

management (concentrated). Information ratios, tracking error, alpha, and downside protection/downside deviation are among the tools to assess the value of higher cost funds.

4. The Framework Document notes that “there will be a suitable low-cost default option for a broad group ...(that) will be permitted to have some risk exposure and still be considered prudent under this framework for the purpose of the fiduciary duty.”

- Should a ‘safe harbour’ provision be implemented and, if so, how should it be designed?
- Should there be certain “qualified” investment for default options or should general parameters be set for establishing default options as prudent. If the latter, what types of parameters should be considered?

Answer: A general principles-based approach should apply in assessing whether or not a default option has been established in a prudent manner, rather than a limited list of “qualified” prudent default options.

- What do you consider to be a prudent level of risk exposure?

Answer: Risk exposure should be based on the risk tolerance of the particular individual, but by definition in a default situation the participant is not sharing their risk tolerance. PIAC believes that to be prudent in such a scenario, there should be some conservative level of risk permitted. By way of example, a target date fund adjusts the asset mix (and thus the level of risk) automatically over time.

- What is the lowest cost life-cycle-type fund that could be designed?

Answer: PIAC recommends careful benchmarking of others stakeholders’ responses to this question with the types of studies mentioned above, and also that costs be considered as only one part of the fundamental overall issue of optimal long-term design.

5. How should the default investment strategy be chosen?

Answer: This should be kept as simple as reasonably possible, for example by offering target date funds built with indexed portfolios.

How much and what kind of diversification should be required in the default fund?

Answer: This can be left to the provider of the default funds to determine, based on prudent principles. With the default target date fund example, the starting and ending asset mix and the rate of adjustment in the balance of equities and fixed income would be the responsibility of the provider.

- Should multiple default options be offered based on contributor's age or risk tolerance?

Answer: The target date funds example would be a staggered range of options linked to a participant's expected retirement age and risk tolerance. The provider would be responsible for setting the mix based on prudent principles, adjusted for age to retirement.

- How would the risk balance be adjusted over time as a contributor ages?

Answer: The provider would be responsible for adjusting the mix as retirement date approaches. Much research and debate on this issue is reflected in various glidepaths and approaches of providers (e.g. steep or flat, gradual or stepped, managed to or through retirement).

### **Administration**

18. How should funds be paid out at retirement?

Answer: PIAC believes it should be in the same manner as funds are paid out of registered pension plans under the current regimes.

19. What types of products (e.g., annuities, RRIFs, lump sum payments) would you recommend to reduce the risks and costs of converting members' plan balances to a secure stream of retirement income?

Answer: PIAC supports the use of all the currently-available products, though harmonization across the provincial and federal legislation on this matter is critical to keeping the administration low cost and understandable to participants.

20. Should members have to transfer assets out of their plan at retirement to a disbursement vehicle, or should the plan be permitted to continue to hold and invest their money, and then pay income out in LIF-like payments?

Answer: PIAC supports enabling the plan to continue to hold and invest their funds and pay income out in LIF-like payments.

21. What regulatory changes might be required to support flexible de-accumulation options at retirement?

Answer: PIAC has no specific recommended changes to propose but feels strongly that any necessary regulatory changes to support this objective should be fully harmonized across all provincial and federal jurisdictions.

22. How could plans make it easier for their members to understand the decisions they need to make at retirement regarding the conversion of their plan assets into an income stream?

Answer: PIAC encourages effective communications between PRPPs and their members, including information and education on cash flow needs. In addition, a regulatory safe harbour for PRPP administrators could be created regarding the information and education that they offer to their members facing those decisions, insulating the administrators from potential legal liability arising from the information, so long as they meet the pre-defined standards set out in the safe harbour.

This should encourage administrators to (1) be forthcoming with information and advice, and (2) meet the pre-defined safe harbour standards (which presumably would be some sort of best-practices standards), all driving towards better understanding by members of their options at retirement and better decision-making.

23. Could professional, business, or sector associations be able to sponsor a plan on behalf of their members?

Answer: Yes. PIAC sees no reason why more availability to investors is a downside.

- What are the potential benefits of having organizations act as a sponsor on behalf of a large group of individual members?

Answer: PIAC believes that associations could facilitate awareness and provide economies of scale for PRPP's for individuals who may not be in a corporate employment situation. Organisations could utilise existing channels of communication with their members (such as websites and newsletters) as cost-effective methods of providing PRPP information and updates.

- What particular responsibilities, apart from plan selection, would sponsors have that would be distinct from plan administrators,

Answer: None, except that sponsors should have responsibilities concerning communications they issue. Plan selection should include the opportunity for sponsors to change plans from time to time

24. Should there be provisions to ensure that employers, both large and small, and self-employed workers can take advantage of the same plan subscription terms (for example, management fees)?

Answer: Yes, there should be a level playing field and consistency for all participants of PRPP's.

### **Disclosure**

26. Are the disclosure requirements contemplated in the framework appropriate?

Answer: Concerning disclosure, PIAC is particularly of the view that there should be no hidden costs. The framework suggests that "all costs and fees" should be disclosed, but we believe that costs and fees should be disclosed on a broken-down basis, rather than in aggregate. Under

question 2 above, PIAC sets out what we believe should be the minimum breakdown of fees required. Concerning investments, the framework refers to disclosure of “Investment performance and relative risks”, but disclosure of benchmarks, exposures, managers and asset classes should also be provided.

27. What degree of detail should be disclosed on costs and fees? How should this be operationalized?
- Can these costs be compared across funds?

Answer: Sufficient detail should be provided so that there are no hidden costs and so that costs can be compared across funds.

### **Locking-in**

28. Should employee contributions be locked in? Are there situations in which unlocking of contributions prior to retirement should be permitted?

Answer: PIAC strongly feels that inter-jurisdictional harmonization is key to the success of PRPP’s and in particular to keeping costs low. It is evident from our experience with Canada’s multi-jurisdictional pension legislative landscape in relation to topics such as locking-in that a lack of harmonization can be a large and inefficient stumbling block which drives higher costs, increases complexity and reduces plan member understanding.

### **Supervision**

31. What should be the role of the supervisor?

Answer: PIAC recommends that existing regulatory structures and roles be utilized to supervise PRPP’s.

33. Given that PRPPs will be offered across the jurisdictions in Canada, how should the supervisory framework be structured in order to be most effective?
- Would it be effective to follow the multi-lateral agreement approach being enacted for RPPs?

Answer: A critical issue in determining its level of effectiveness would be the level of harmonization between the PRPP legislation in each of the federal and provincial jurisdictions. Inconsistency in rules relating to individual-member matters could lead to a meaningful increase to administrative costs.

### **Harmonization**

34. What design elements of the framework are most important to be harmonized and to what degree?

Answer: PIAC believes it is critical that all material elements of the PRPP framework should be fully harmonized. If harmonization is not achieved, the PRPP regime may be significantly flawed.

35. How will harmonization impact size, scale and costs of PRPPs?

Answer: A lack of harmonization could lead to higher costs, deterring participation in PRPPs and thereby reducing the size of PRPPs and the ability of PRPPs to achieve economies of scale.

## Appendix B

March 31, 2011

### Pooled Registered Pension Plans – PIAC Responses to Questions posed by Mr. Calof

Question #1: “Do you happen to have something written that can break down and identify all the costs in running the fund (and by “costs”, I believe the description on Tuesday that someone gave of anything that reduces the return on the investment), whether these costs are relatively fixed or as a percentage of assets, and what reasonable ranges of these costs might be? Much of the data we have is from retail; institutional data is not as easily available.”

Answer: In our attached response to Q2, 1st bullet, we lay out the range of different costs that reduce member’s investment return or accounts. Some of these costs are directly related to investment management and these are expressed as basis points. Other operational costs should not be expressed as basis points but as fixed dollar costs per member account. The Cost Effectiveness Measurement research we mentioned can provide ample detail on benchmarking these costs.

Question #2: “When I quoted some MERs on life cycle funds, you noted that these were mutual funds, and I believe you said that funds could be provided on an institutional level for much less (around 25-30 bps?). Does this include all costs? Do you have any information on what an inexpensive life cycle fund would cost?”

Answer: Mr. Calof mentioned that MER's for life cycle funds were 2.5% to 3%. Ms. Van Riesen on behalf of PIAC pointed out that these fees are mutual fund fees, not fees that a defined contribution plan sponsored by an employer would be able to obtain for their employees participating in such a plan.