Advocis

Advocis
390 Queens Quay West, Suite 209
Toronto, ON M5V 3A2
T 416.444.5251
1.800.563.5822
F 416.444.8031
www.advocis.ca

April 16, 2010

Pension Policy
Alberta Finance and Enterprise
#402, Terrace Building
9515 – 107 Street
Edmonton, AB
T5K 2C3

Dear Sir or Madam:

Advocis, The Financial Advisors Association of Canada, is Canada's oldest and largest voluntary professional membership association of financial advisors and planners. We represent life and health insurance licensees and mutual fund and securities registrants across the country. Advocis members pride themselves on the service and advice delivered to individuals and the business community, particularly small-and medium-sized companies through the provision of professional financial advice and insurance and financial service products. This includes group RRSPs, deferred profit sharing plans and defined contribution ("DC") plans (hereinafter referred to collectively as "Capital Accumulation Plans or "CAP Plans") and defined benefit ("DB") plans.

Advocis has established a Retirement Income Adequacy Committee whose mandate is to identify retirement and pension issues that are of concern to Canadians and to promote a sound retirement income system in Canada including reforms to improve retirement income adequacy for Canadians now and in the future.

Pension coverage, retirement income adequacy and the necessary reforms are major public policy issues. We commend the Alberta Government for making it a priority to address pension gaps for its citizens that do not currently participate in a pension plan.

Retirement planning is a priority for most Canadians and our 10,000 members (over 1,500 of which operate in the Province of Alberta) work with individuals, families and businesses in achieving their financial objectives. Our members provide comprehensive financial advice to Canadians through all stages of their lives including estate and retirement planning, wealth management, risk management, tax planning, employee benefits, critical illness and disability insurance. Our members provide retirement planning and investment advice to employees with CAP Plans, with RRSPs and TFSA's and our members also establish and administer CAP Plans and DB plans for small and medium sized businesses.

General Comments

Advocis would like to stress that a broad focus encompassing all types of retirement savings is required. Advocis has examined existing barriers to establishing and maintaining pension plans and incentives to encourage small and medium sized employers to participate in pension plans. We have looked at the important aspects of the retirement income system in Canada and offer some practical solutions for improvement. Last September Advocis commissioned a study entitled "Encouraging Small and Medium Sized Firms to Participate in Pension Plans"[1]. The study examined barriers to establishing and maintaining pension plans and incentives to encourage employers to participate in pension plans. The report makes practical recommendations to support the establishment of more pension plans and higher retirement incomes for Canadians.

The study concluded that the most appropriate type of employer sponsored pension plan is a defined contribution plan, especially for small and medium sized business enterprises. Public policy should focus on how to improve the regulatory environment for such plans. Indeed, Advocis believes that public policy should reinforce the strong financial attributes of all CAP Plans.

There are a number of barriers that prevent employers from establishing CAP Plans and Advocis has a number of recommendations (set out below) to reform the pension and retirement income system so as to remove barriers and create incentives that will improve pension coverage and the retirement income system for all Canadians.

Advocis strongly believes that professional financial advice is needed by the majority of Canadians in order to lead to good consumer financial outcomes, not only in the areas of retirement income savings, but in a whole host of other areas as well such as planning for a child's education and long-term health care needs. Public policy needs to foster an expansive role for professional financial advice in order to ensure that Canadians can meet their retirement income and other financial goals. Canadians should not be expected to serve as their own financial experts but should have the ability to obtain professional financial advice so that they have safe and adequate retirement savings.

Advocis will provide comments on the following questions: 1, 5, 6, 7, 8, 10, 11, 12, 14, and 15.

<u>Comment on the Principles and Objectives Identified in the Consultation Paper</u>

Advocis is generally supportive of the Principles and Objectives set out in the Consultation Paper. Advocis believes that the statement "Canadians should have effective means to achieve a smooth transition from work to retirement, suffering no significant drop in their standard of living" is an important principle. Advocis believes that Canadians currently have the necessary tools or means in order to achieve a smooth transition to retirement; the problem is one of affordability.

Advocis would like to stress that what is required is the strengthening of existing means through needed reforms. This would include, but is not limited to, a combination of higher and more flexible tax assisted contribution limits, longer accumulation phases past age 71, deferred and reduced requirements for income commencement and substantially more "user friendly" rules for employer sponsors which will improve the system.

Advocis supports a national approach to retirement income system reforms as this will allow all Canadians to have the same opportunities to save and invest and be adequately prepared for

---

[1] Gunderson, Morley and Wilson, Thomas, 2009. "Encouraging Small and Medium Sized Firms to Participate in Pension Plans." Prepared for Advocis: The Financial Advisors Association of Canada.

their retirement. A national approach would also lessen regulatory compliance costs and burdens for participants who operate in more than one province. Advocis urges governments to harmonize regulations, particularly with respect to locking-in rules, between provinces and federally to reduce complexities and costs for employers and employees.

Advocis agrees with the objective that pension or *retirement savings* (added by Advocis) coverage among private sector workers should increase. Employers and employees need to be encouraged to participate in retirement savings plans and barriers should be removed and incentives put in place which will facilitate employers offering retirement savings plans for their employees.

Advocis urges the government to include as a principle that Canadians should have the choice of how they accumulate savings for their retirement.

Solutions should target those at risk of not being able to meet their non-discretionary expenses in retirement. To achieve a standard of living that is similar to that enjoyed during pre-retirement, the measurement of replacement rate of income is generally utilized. It should be stressed that the correct replacement rate is not a one-size fits all answer and depends on what the individual's standard of living was pre-retirement, and what a person's goals, expectations and plans are for their retirement years.

Policy should also recognize that people may choose to retire "early" or may choose to continue to work beyond the traditional retirement age of 65.

<u>Advocis' Response to the Questions in Consultation Document</u>

1. Is there merit in pursuing options to expand the existing CPP as a way to improve retirement income adequacy for future Canadian retirees?

Advocis does not, at this time, support expansion of the CPP as a way to improve retirement income adequacy for future Canadian retirees.

Advocis urges the government to allow private sector pension reforms to be implemented and given a chance to succeed prior to giving serious consideration to changes to Pillar 2 (CPP) of the retirement income system.

In addition, Canada's deficit situation and the existing tax burden for employees and employers does not support the imposition of an additional tax burden on employers or employees that would be required to expand the CPP.

5. Do you think that participation in a supplementary plan should be completely voluntary, voluntary but only through being permitted to opt out after being auto-enrolled, or fully mandatory? Is mandatory enrolment necessary to ensure pension coverage is substantially increased?

Advocis believes that governments should implement reforms to the existing private sector pension and retirement savings system (Pillar 3) before implementing any new retirement savings structure.

Advocis is not in favour of a government legislated supplemental pension plan as described in the consultation paper that does not allow for a level playing field with the private sector and that may crowd out existing retirement savings options for consumers and employees.

The costs to set up and run the plan will be significant for Alberta and BC (or other provinces if they join) taxpayers, including those who do not wish to participate in such a plan. Such costs should not be incurred at this time before allowing reforms to the existing system being implemented.

6. **Under a new supplemental voluntary plan, it is envisioned that investment choice would be limited, to keep costs down and utilize expert investment management. How much investment choice do you think is necessary to provide sufficient flexibility for individuals? Is there such thing as too much choice?**

Advocis believes that having a limited number of investment choices appropriately chosen can provide sufficient flexibility for most members of plans. Age-adjusted balanced portfolios that become more conservative as the member approaches retirement age can be a suitable investment choice but should not be mandated. It should be up to the individual to choose the investments most suited to their individual needs.

With individual advice, having a greater degree of investment options to choose from is not problematic as the role of the financial advisor is to provide product suitability recommendations based on the needs, financial goals and other individual circumstances of the client.

7. **Should the supplemental plan have features that lessen risk to the individual, such as shifting the individual's investments gradually to less-risky investments over time, and/or purchasing annuities gradually as the individual nears retirement age? Should these features be automatic or should they also be a choice offered to individuals?**

Advocis supports offering these features to consumers but does not believe they should be mandated.

8. **Will modernizing pension standards legislation to encourage pension innovation result in increased pension coverage? If yes, why? If no, why not?**

The modernization of pension standards legislation so that complexities and costs to employers are reduced as well as harmonizing the legislation between provinces, will encourage more employers to offer a pension plan to their employees. This will likely increase pension coverage.

Reducing barriers will improve pension coverage but incentives so as to encourage employers to offer these plans are also required. Otherwise, increased pension coverage will not be as great as it otherwise could be. Governments should explore tax incentives for small and medium sized businesses that choose to offer pension plans to their employees.

Employers should themselves be recognized for their sponsorship of pensions. Employers who are well-versed on the issues associated with retirement planning tend to be more interested and we would suggest more inclined to offer benefits to employees.

10. **A number of stakeholders have suggested that very large pension funds are required in order to minimize costs through economies of scale and maximize investment**

returns. Do you agree? Are there risks associated with pension funds that become very large?

Advocis members strongly believe that it is not simply a question of lowering administrative costs that will lead to Canadians having adequate savings for their retirement and other financial goals. Private sector CAP plans may have higher management and administrative costs than large scale pension funds, however, these plans have proven to be of great value to many Canadian employers and employees and have allowed many Canadians to accumulate savings for their retirement years and thereby serve a vital role in the third pillar of the retirement income system.

The value of the advice provided to plan members in setting up these plans and to members of these plans needs to be acknowledged. Plan members may receive advice through retirement planning sessions held at the place of employment or receive one-on-one individual advice as members of these plans. Canadians are assisted in achieving their retirement income goals through the ability to access such advice. This advice is valued by plan sponsors and participants and is part of the overall cost of administering employer sponsored plans. The government should be extremely cautious on how it compares administrative costs between CAP plans and costs associated in running a government legislated supplemental plan. This comparison should also take into consideration long-term net returns in determining the retirement incomes that will accrue to Canadians.

Advocis strongly believes that professional financial advice is needed by the majority of Canadians in order to lead to good consumer financial outcomes. In our view, Canadians who have professional financial advice have better financial outcomes than those who "do it alone".

Public policy needs to foster an expansive role for professional financial advice in order to ensure that Canadians can meet their retirement income and other financial goals.

11. Could other potential changes to the federal or provincial legislative and regulatory framework for pension plans and retirement savings help improve pension coverage and increase retirement savings?

Advocis strongly believes that tax reforms should be implemented to foster pension coverage. Through tax reforms DC plans can be placed on a more equitable footing with DB plans. There are also reforms to RRSPs that can be made to improve that form of retirement savings. Our recommendations are:

- Contribution limits for CAP Plans and RRSPs should be increased if participants in CAP Plans and RRSPs are to achieve retirement incomes comparable to participants in public sector DB plans. As a first step, contribution limits should be increased to 20% of earned income and the maximum dollar limits should continue to be indexed. Further increases in these limits should be a priority for future fiscal policy.

- The current two year 100% vesting rule should be replaced by gradual vesting over a 3-year period from the date of plan enrolment, with 1/3 at the end of the first year, 2/3 at the end of the second year and full vesting at the end of the third year (the employees contributions are, of course, fully vested from the beginning). This would provide employers with an improved incentive to open a pension plan. The employee would have a greater incentive to remain with the company over a longer period, while at the same time, providing some compensation to employees who leave the company before the three-year period. With this approach, employees always receive their money plus a share of the employer's money at termination of employment. Non-vested forfeitures should only be used to offset an employer's current service contributions.

- While it is recognized that the tax assisted private retirement planning system in Canada creates significant deferrals, ultimately the tax will be paid. Accordingly, administration rule amendments such as: a reduction or change in minimum withdrawal rates; a longer window for deferral, i.e. to age 75 and the ability to defer tax for prescribed pension amounts while still actively employed (ie voluntary private and public pension rollovers) would create larger pools of capital for the individual to supplement their retirement income at a later date, and for governments to ultimately tax.

- Contributions to retirement savings plans should be determined on a life-time average basis in order to not penalize those individuals with fluctuating incomes and individuals whose income increases rapidly later in their working lives. This would allow any earned income in excess of the contribution limit in a year to be carried back or forward to create additional contribution room for years where earned income was below the limit. Any taxable withdrawals from an RRSP or CAP Plan in a year would create future RRSP contribution room. This would allow individuals with career interruptions to make up for years with little or no income by permitting extra contributions in subsequent years of high earnings.

  For DC plans, employees and employers should be allowed to make past service contributions based on prior year's earnings up to the limit of the individual's unused RRSP contribution room.

  This would also allow individuals to draw down their pension savings to finance other needs (as is currently allowed with RRSPs) without permanently impairing their ability to save for retirement.

- Regulators should be reminded that through DB plans, pensioners do not bear the risk of loss of capital that accrues through negative investment returns and inflation. Such is not the case in DC plans.

- The age limit for contributions to retirement savings plans should be increased from age 71 to 75, implemented over a 4-year phase in period given the fact that people are living longer and continuing to work post-retirement.

- As described in answer to question 8 above, government should explore tax incentives for employers of small and medium sized enterprises who sponsor pension plans.

- The withdrawal of amounts upon retirement from locked-in retirement accounts should be amended to reflect the fact that interest rates are low, Canadians are continuing to work post-retirement and are living longer.

12. **Currently, Pillars One and Two (OAS, GIS and CPP) are designed to provide 40 per cent of career average wages at the normal retirement age of 65. Individuals with lower incomes will receive more than 40 per cent of career average earnings from Pillars One and Two, and individuals earning incomes greater than the average wage over their working lives will receive less than 40 per cent. Pillar Three (voluntary savings through RPPs, RRSPs and TFSAs) is expected to provide the**

remaining income to meet Canadians' retirement income goals. Is this the appropriate balance between the three pillars of Canada's retirement income system, or should some other apportionment be pursued?

Advocis believes that the current apportionment of the three pillars is the appropriate balance (with the modifications to OAS and GIS listed below), so long as reforms are made to the third pillar to encourage greater participation in private sector pension plans, including CAP Plans.

Advocis recommends the following changes to the OAS and GIS:

- Guaranteed Income Supplement (GIS) recipients should be permitted to claim non-refundable tax credits that eliminate the personal income tax that they would otherwise pay. This would reduce their effective marginal tax rate to 50% - the basic GIS claw-back. This reform would resolve the serious disincentive to saving through RRSPs or DC Plans that currently exists given the high post-retirement effective marginal tax rates.

- The Old Age Security (OAS) claw-back of 15% should be reduced to 10.5 percent, if not abolished. The OAS claw-back creates a dramatic ballooning of marginal and effective tax rates post-retirement. The OAS claw-back is a major deterrent for middle income working Canadians to continue to contribute to society through their work after age 65 and has an adverse incentive effect for retirement savings for some individuals.

14. Can you think of other examples of blended approaches that would achieve increased pension coverage for future retirees?

Private sector reforms should first be given a chance to be successfully implemented before potentially costly reforms are made to the second pillar of the income system or government legislated supplemental plans are introduced.

15. What measures show the greatest promise of increasing pension plan coverage and retirement income adequacy for Canadians?

Advocis strongly supports reforms to the regime for CAP Plans, as these plans are the best type of pension plan for small and medium sized enterprises. The change from DB to DC plans and the growth of CAP Plans reflects their attractiveness.

We also support tax reforms to RRSPs for those Canadians who utilize this form of retirement savings, as set out above.

We appreciate the opportunity to provide our comments to the government as it considers reforms to the retirement income system.

Yours sincerely,

Greg Pollock	Terry Zavitz, CFP, CLU, RHU, GBA, EPC
President and CEO	Chair, National Board of Directors