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March 31, 2011

Lynn Hemmings
Senior Chief
Financial Sector Division
Financial Sector Policy Branch
Department of Finance Canada
Ottawa, Ontario
K1A 0G5

Dear Ms. Hemmings:

Re: ***Framework for Pooled Registered Pension Plans***
List of Key Questions for Stakeholders dated February 8, 2011 and Additional Questions from March 8, 2011

Advocis, The Financial Advisors Association of Canada, is pleased to provide comments in response to the Department of Finance's request for response to a List of Key Questions on the Pooled Registered Pension Plans Framework, and subsequent additional questions.

Advocis 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 comprehensive professional financial advice and insurance and financial services 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.

General Comments

Pension coverage and retirement income adequacy are major public policy issues. We commend the federal and provincial governments for making it a priority to strengthen the retirement income system. Reforms should be implemented to improve pension coverage and retirement income adequacy so that more Canadians can retire with adequate retirement income now and in the future.

Retirement planning is a priority for most Canadians and our 11,000 members work with individuals, families, and businesses to reach their financial goals. 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, RRSPs and TFSA's and DB plans, and establish and administer CAP plans and DB plans for small and medium sized businesses.

Advocis believes that employees and employers should be encouraged to participate in retirement savings plans. Barriers to participation should be removed and incentives put in place which will facilitate employers offering retirement savings plans for their employees and result in more employees being members of a plan.

Advocis believes that Canadians currently have the necessary tools or means to help save for retirement (RRSPs, TFSAs, CAP plans, DB plans, etc); the problem is one of being able to afford to save for one's retirement; providing the right incentives so that Canadians will be more inclined to save now for their retirement years rather than choose to spend it on other priorities; and strengthening existing tools or means through needed reforms.

In 2009, Advocis commissioned a study entitled "Encouraging Small and Medium Sized Firms to Participate in Pension Plans"[1]. The study confirms that the number of Canadian employees who are participating in any form of employer sponsored pension plan has been declining and that only a minority of Canadians in the private sector have an employer sponsored pension plan[2]. Many Canadians do not have an employer sponsored pension plan or CAP plan and, therefore, have less choice and fewer options available to them with respect to saving for their retirement.

Advocis believes that employees and employers should 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 and result in more employees being members of a plan.

Therefore, Advocis support reforms to the third pillar of the retirement income system to encourage greater participation in private sector pension plans, including Capital Accumulation Plans ("CAP") Plans include group RRSPs, deferred profit sharing plans and defined contribution ("DC") plans.

Need for Individual Professional Financial Advice

Advocis strongly believes that professional financial advice is needed by the majority of Canadians in order to lead to good consumer financial outcomes, in the area of retirement income savings and 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 should foster an expansive role for professional financial advice in order to ensure that Canadians can meet their retirement income and other financial goals.

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[1] Gunderson, Morley and Wilson, Thomas, 2009. Encouraging Small and Medium Sized Firms to Piriticpate in Pension Plans." Prepared for Advocis: The Financial Advisors Association of Canada.
[2] The Consultation Paper states that only 18 per cent of private-sector workers in Canada have a pension plan.

Professional financial advisors help Ontarians to save and plan for their future financial needs. People who do not receive financial advice save less than those who do obtain advice. This has been shown to be the case, regardless of the age and annual income of individuals[3].

Advocis welcomes the opportunity to provide its comments on the Framework for Pooled Registered Pension Plans ("Framework" or "PRPPs"). Advocis is pleased to work with the government and other stakeholders to ensure that this potential new savings vehicle is structured in a manner which will help the government achieve its stated policy objective of having Canadians save adequately for their retirement. Advocis is pleased to see the government consult broadly with stakeholders, early in the process, as it develops the Framework.

Advocis strongly believes that individual financial advice is key to the potential success of the Framework; otherwise participants will not have optimal outcomes.

The government must ensure that the Framework for Pooled Registered Pension Plans (the "Framework" or "PRPPs") has, as an integral part of the PRPP, a role for professional financial advice. Savings outcomes will be improved if advice is included and is an integral component of the Framework.

Advocis will provide responses to Questions 1,2, 4 to 9, 11, 12, 17, 26, 27, and 28. The additional questions from March 8, 2011 are also identified below and are inserted as further explanation to the main questions, where appropriate.

<u>Investments and Cost of Investments</u>

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 (ie type of assets in the funds)?**

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

Advocis believes that the CAP Guidelines (CAPSA Guideline No. 3) should be followed by those entities offering a PRPP.

Advocis believes that the number of investment choices can be limited to some extent and still 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.

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[3] See the report, The Value of Advice, July 2010, published by the Investment Fund Institute of Canada: http://www.mackenziefinancial.com/en/pdf/ific_voa/report.pdf.

However, it should be noted that if the consumer receives 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.

Passively managed index funds can be a suitable investment choice and would be a lower cost option for investors. It should be up to the individual to choose the investments most suited to their individual needs, with the assistance of a professional financial advisor.

The number of investment choices should not, in our opinion, be prescribed by regulation. The market should provide for simpler and fewer investment options if these are seen as desirable[4]. The investment rules in the *Pension Benefits Standards Act, 1985* should also be applicable.

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?**

- **What are the drivers of cost?**

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

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

    - **Is there a particular threshold at which a cost is no longer low?**
    - **Should there be a limit on fees for the low cost investment option?**

The Framework states that "PRPPs will be designed to result in large pools of capital with low costs, while helping members to construct portfolios consistent with each member's particular investment needs and objectives.

If structured properly, competition amongst providers should lead to fees that reflect the cost of providing the plans plus normal profits. Competition amongst providers should lead to lower fees. These issues have to be taken into account so that fees, costs and complex investment options do not become barriers or unduly increase the costs of the PRPP.

Advocis strongly believes that it is not simply a question of lowering costs that will lead to Canadians having adequate savings for their retirement and other goals. Costs cannot be looked at in isolation from risk and expected return on one's investment or return on assets. The role of financial intermediation is to reduce risk and information costs for investors. Intermediaries pool diversified investments together to reduce risk faced by intvestors. Financial intermediaries also monitor the quality of investments

[4] Gunderson and Wilson, at page 4-26.

and these activities cost money. Investors, therefore, accept a lower return on their investments in exchange for avoiding risk and information costs[5]. The expectation of investors when financial intermediaries are used is that the investor will obtain better investment performance even though greater costs are incurred to do so[6].

Dr. Vijay Jog in "Investment Performance and Costs of Pension and Other Retirement Savings Funds in Canada: Implications on Wealth Accumulation and Retirement" dated December 2, 2009 conducted a detailed analysis of investment performance and costs. His findings include the following:

- Mutual fund performance in the United States and Canada – studies have shown that active managed mutual funds do not perform better than passive investments in indexed and exchange traded funds. Given the management fees that are incurred, investors therefore receive a lower return on their active managed investments compared to passive strategy investments.

- Active management by pension plans does not lead to persistently better performance than passive investment strategies on a sustained basis.

The advice that is currently allocated to actively manage the bundle of assets under management should arguably, given the foregoing, be reallocated to the consumer so that they can obtain individual professional financial advice about whether to join the plan, the investments that meet their individual needs and objectives and other related financial advice.

What should be included in the definition of costs?

According to Mintz, costs include administrative costs, reporting requirements, advice, asset management, taxes and any reserve costs to fund guarantees (in the case of insurance). Mutual fund costs include asset management costs, advisory costs and other trading expenses (administration, trustee/custody, audit and legal fees)[7].

Vijay Jog breaks down mutual fund costs in retail market as follows: cost of administration including GST; cost of on-going individual advice; cost of active management and cost of passive product[8].

Advocis believes that all of the elements of costs should be examined in determining the cost of the PRPP.

The government should be extremely cautious in how it compares costs between various plans, investment funds and Group RRSPs and other CAP Plans, given differences between them. Any comparison should also take into consideration long-term net returns in determining the retirement incomes that will accrue to Canadians and whether individuals would have invested as much without the assistance of professional financial advice.

[5] See Jack Mintz, Summary Report on Retirement Income Adequacy Research, December 18, 2009 at page 17
[6] Mintz, at page 18.
[7] Mintz, at page 21.
[8] Jog, at page 11.

<u>Supplemental Questions, March 8, 2011 on Cost</u>

How would you define a reasonable total cost?

A reasonable total cost to the consumer would necessarily include the profit margin for the pension fund manager, administrative costs (including any GST), reporting requirement costs, advice to the consumer and asset management costs.

Currently, it is our understanding that costs for a defined contribution pension at a small employer can be in the range of less than 100 bps, and this is without advice. With economies of scale, the cost could be lowered.

Advocis strongly believes that the cost of advice to the consumer should be included as part of the Framework. Given the Mintz Report and the Dr. Vijay Jog's findings, it is better to opt for passively managed funds and reallocate the advice cost component to the consumer rather than allocate the advice to the basket of underlying assets in an actively managed fund scenario. Advocis believes that many pension funds have wrongly allocated the advisory costs to the active management of the fund rather than to the consumer.

What are the costs (or range of costs) for each specific component of the total?

Advocis does not have accurate information on the range of costs for each element of total cost. However, Advocis can advise you that advice costs are in the range of 15 to 35 bps with the average being 25 bps.

What methodology would you use to separate administrative and management costs? That is, what costs could be applied to individual members as opposed to the fund?

What disclosure elements of this would best allow plan members to compare and understand the impact of costs?

The explanation of costs provided to consumers should be consistent with existing pension legislation and all jurisdictions should consider including:

- A description of all of the major categories which make up the total cost of the investment and their values (in a pie chart or otherwise);
- How costs impact on the return on investment over time; and
- How cost is related to risk and potential returns.

How many options would you consider appropriate?

Please see the response to Question 1, above.

Who would you suggest should provide risk-to-cost guidance on default options?

Advocis strongly recommends that financial advisors provide the risk-to-cost guidance on the default options as they would have the expertise to explain this to consumers. In addition, this would help alleviate any conflict of interest issues in having the Eligible Administrator provide this information.

(IFIC) What methodology would you suggest for benchmarking performance to allow for comparison against fees? How would you structure disclosure to permit plan members to quickly comprehend and compare the performance against fees charged across products and providers?

Benchmarking performance to compare fees, and disclosure to employees and employers should be consistently reported across all financial services sectors so that there is a level playing field and the consumer can readily compare products, returns and costs. Existing securities regulation should be seen as a starting point for determining required disclosure.

(Advocis) What specific low-cost channels are you proposing? Are these used in other jurisdictions? If so, have there been any studies on their effectiveness relative to in-person advice?

Advocis recommends the use of passively managed funds such as index funds so that advice is provided to the individuals who participate in the plan rather than to the fund for managing its basket of assets.

Advocis recommends that PRPP's offer one-on-one individual advice to consumers so that consumers can decide whether (a) to join the PRPP or whether contributing to a different savings vehicle such as a TFSA would be more suited to their individual needs and circumstances; (b) the amount to contribute to a given registered pension plan and (c) what investments to choose within that plan.

For example, without professional financial advice, many employees will not be able to determine whether or not tax deductible products (pooled RPP, RRSP, etc) would be better than putting their money into TFSAs and regular savings. The complexities of the Income Tax Act are such that it is quite difficult to determine if the full deductibility followed by full taxability of registered products best suits a taxpayer's interests. For lower income earners, the benefits of the tax deferral provided by TFSAs may be better. Therefore, without advice, many employees will not have optimal outcomes for their savings and will be negatively affected, as a result.

The current cost of Individual professional financial advice for defined contribution pension plans is in the range of 15 to 35 bps and has been provided in certain circumstances for as little as 10 bps.

Financial advice should be provided by someone who has the necessary licensing and qualifications/designations to provide advice on the range of investments offered by the pooled PRPP.

(PIAC and IIAC) If passive funds are used for initial default, at what threshold would you consider it appropriate to permit active funds to be included? Is there another methodology you feel would be more appropriate to use?

For the reasons given above, Advocis strongly believes that passive funds should be used for the default rather than actively managed 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?**
- **What do you consider to be a prudent level of risk exposure?**
- **[Plan Administrators: Do you presently offer lifecycle funds? What does it cost, and what are the major drivers of cost. What is the lowest cost life-cycle-type fund that could be designed?]**

Any safe-harbour that is considered should be at the level of the employer who offers the PRPP.

Advocis believes a level playing field should be maintained between existing single employer defined contribution pension plans and the proposed pooled registered pension plans. Unless a safe harbour is extended to all pension plans, a safe harbour provision should not be provided here. Any safe-harbour provision that is considered should also be offered or already exist in provincial or federal legislation (such as Bill C-47).

5. How should the default investment strategy be chosen?

- ***How much and what kind of diversification should be required in the default fund?***
- ***Should multiple default options be offered based on contributor's age or risk tolerance?***
- ***How would the risk balance be adjusted over time as a contributor ages?***

Default options cannot pretend to provide an investment selection which will meet the individual needs and circumstances of all participants. This is why professional individual financial advice is essential to ensure that Canadians can meet their retirement income and other financial goals and ensure, as stated in the Framework:

- "PRPPs will be designed to result in large pools of capital with low costs, while helping members to *construct portfolios consistent with each member's particular investment needs and objectives.*"

- "…permit a reasonable and prudent person to *create an appropriate portfolio in respect of his or her own investment objectives and risk preferences*…"
- "…members will be given the opportunity to *select an investment mix consistent with their retirement savings objectives*. The administrator will provide the member with educational tools and other resources to permit him or her to make an informed choice." *(emphasis added by use of italics)*

Auto-enrolment

An employer that chooses to offer a PRPP will enroll its employees (or certain classes thereof) into the plan it has chosen. According to the Framework, employers may be permitted to enroll their employees into a PRPP during the tenure of the employee's employment, and not simply at the hiring stage.

6. Should employers be permitted to enroll existing employees into a PRPP (i.e., not simply at the hiring stage)? If so, should the employee be required to consent or have the ability to opt-out?

Studies appear to indicate that participation rates with auto-enrollment are significantly higher than if active consent has to be provided by the employee before entering into the plan. To ensure that individuals have optimal outcomes for their savings, individual advice needs to be provided to individuals before or around the time of auto-enrollment to ensure that the plan that the individual has been auto-enrolled in, suits the individuals needs and circumstances.

7. If able to opt out, how should an opt-out be structured for employees that are automatically enrolled into a PRPP?

- **Should there be a certain period of time following enrolment that opt-out would be permitted?**
- **How should contributions be treated when individual opts-out (e.g. market rates?, protected?)**

Opt-out should be allowed for a certain period of time subsequent to the provision of individual financial advice. In addition, employees should have the ability to move their assets to another PRPP (if the employer does not contribute) or other retirement savings vehicle. This will allow for more competition between PRPPs and other savings options and allows for individual consumer choice and recognizes that a one-size fits all approach will not lead to optimal outcomes for Canadians.

8. Should employer participation be mandatory unless the employer already sponsors an RPP?

No. Advocis believes that employer participation in PRPPs should not be mandated, even if the employer does not currently sponsor a pension plan. Advocis believes in encouraging employers to offer and participate in retirement savings plans but does not think the government should mandate this behaviour as this removes individual choice. Some employers will not have the financial or administrative ability to offer a PRPP and should not be forced to do so.

While reducing barriers will increase pension coverage, incentives to encourage employers to offer these plans are also required. Otherwise, pension coverage will not be increased as much as it otherwise could be. Governments should explore tax incentives to encourage small and medium sized businesses to offer pension plans to their employees.

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. Improvements to financial literacy amongst Canadians should be supported. Employers should be made aware of likely participation rates if they make an employer contribution versus likely participation rates if they do not, and the implications for employee retention if a pension plan is offered, for example.

9. How should default contribution rates be set for member auto-enrolment and who should set the contribution rates?

- **Should all members have the same default contribution rate, or should it vary by age, tenure or other factor?**
- **What criteria should be used to set contribution rates?**
- **What is the relationship between default contribution rates and the rate at which people opt out of pension plans in other jurisdictions?**
- **Should members be offered additional financial information if they want to change their contribution rate?**

There should be a choice of contribution rates for individuals enrolled in the PRPP and for employers who choose to make contributions to a PRPP in order to allow for individual needs and circumstances.

Employees and employers should be provided with financial information that will demonstrate the short and long term effects on the amount of retirement savings accumulated based on different contribution rates and the age (or length of time) at which contributions begin.

11. What would be the responsibilities and requirements of an employer that does not contribute to the proposed plan (duty to inform employees, providing the plan if a sufficient number of employees request it, choice of plan, terms and conditions, payroll deductions)?

The Framework states that an employer that offers a PRPP (even it does not contribute) would have the following responsibilities:

- Selecting a plan and enrolling its employees into that plan, which may involve a choice to move from one plan to another from time to time;
- Determining a level of contributions at the employee level;
- Collecting and remitting contributions to the plan; and
- Informing the administrator of new members and terminations of employment; and

- Disclosure requirements such as informing employees of any new participation in a PRPP or whether the employer has chosen to move to a different plan.

The Framework should include the ability of the employer to access financial advice so as to obtain assistance in determining which pooled PRPP to choose or whether it should offer a pooled PRPP versus a different savings vehicle for its employees.

Eligible Administrators

17. To encourage competition between plan administrators, should there be terms that enable employers to change plan administrators? If so, what should these be?

Employers should have the ability to change plan administrators or transfer to another plan as is currently allowed under existing pension legislation.

If there are no employer contributions to the pension plan, there should be the ability of employees to recommend to the employer that the employer transfer to another plan.

Administration

Advocis strongly believes that professional financial advice is important, not only during the accumulation phase of retirement savings planning, but also during the de-accumulation phase. With the assistance of financial advice, consumers will be better informed about their options upon retirement and make better decisions in accord with their individual needs and circumstances.

Disclosure

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

The disclosure requirements should follow requirements set out in the CAP Guidelines (CAPSA Guideline No. 3) in order that there is a level playing field between pension plan providers.

27. What degree of detail should be disclosed on costs and fees? How should this be operationalized?

- **Can these costs be compared across funds**

Please see above comments on costs.

Locking-In

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

In general, Advocis is of the view that funds in a pension plan should be preserved for use during a person's retirement and not used for other purposes. Advocis also supports the harmonization of unlocking rules amongst provinces and federally.

Advocis believes the legislation should allow for withdrawals in the following situations: for (1) small amounts; (2) considerably shortened life expectancy; (3) the case of financial hardship; and (4) if a non-resident of Canada. Advocis would also recommend allowing 25% unlocking at age 55.

Advocis believes that there should be unlocking of funds from a locked-in retirement account in situations of financial hardship. We refer the Government to the Ontario rules regarding unlocking of pension funds which allows unlocking of funds in the following situations: in cases of low income; if there is risk of eviction from a principal residence or rental premises; to access the funds for medical treatment for the person, their spouse or dependents; and if needed for residential renovations, alterations or construction to accommodate the use of a wheelchair, or other needs related to a disability or illness. Financial hardship rules should be harmonized across the country.

Unlocking of locked-in accounts such as LIRAs, LIFs and LRIFs should be allowed after reaching the age of 55 and should be limited to 25% to provide for greater security that sufficient funds will remain to service the person over their remaining retirement years.

The unlocking of the 25% should not be limited to a one-time opportunity to unlock but rather there should be a periodic opportunity to unlock (on an annual basis, for example). This would ensure that people do not unnecessarily unlock 25% when they do not have a pressing need to do so but nonetheless unlock the funds as a result of it being their only opportunity to do so.

Duty of the Administrator

The Framework provides that "Regulated financial institutions that are capable of taking on a fiduciary role will be eligible administrators of PRPPs." "In order to protect the interest of plan members, the administrator will have a fiduciary duty to plan members."

Supplemental Questions, March 8,2 011:

If fiduciary responsibility to plan members is retained, what particular administrator responsibilities do you feel would need explicit legal clarification?

(IFIC, Advocis, ICAC) How would using alternative existing standards provide the same or superior protection to plan employees than a fiduciary standard?

Advocis has a concern with the inherent conflict of interest that exists in allowing financial institutions to sponsor and administer pension plans while at the same time acting in the best interests of plan members. The fact that the administrator will have a fiduciary duty to plan members while, at the same time, have obligations to shareholders to maximize their profits, is a conflict.

This gives rise to potential issues regarding the level of disinterested advice provided to employees by the administrator, the risk of the pooled RPP becoming a proprietary product of the financial institution offering it or the possibility that plan participants will be directed into specific products for which the institution wants to increase assets under management. Advocis recommends that the government consider the establishment of a Committee similar to that of the Independent Review Committee for Investment Funds which could oversee all decisions involving an actual or perceived conflict of interest faced by the administrator.

Advocis does not recommend that the standard of care for PRPPs should be lowered from that which applies to existing pension plans. All consumers or employees should have the same level of protection and a level playing field should be maintained.

Harmonization

Advocis supports harmonization of pension legislation across the country so as to reduce complexities and costs to employers and encourage more employers to offer a pension plan. Harmonization of PRPPs should be advanced ideally so that existing pension plans can also benefit from the harmonization efforts and a level playing field is maintained while at the same time, ensuring that requirements that provide for consumer protection are not diluted.

We appreciate the opportunity to provide our comments to the government as it considers reforms to the retirement income system. If you have any questions regarding our responses, please do not hesitate to contact us.

Yours sincerely,

Sincerely,

Greg Pollock, M.Ed., LL.M., C.Dir., CFP
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