Submission to the Department of Finance on Federally Regulated Private Pension Plans

Canadian Life and Health Insurance Association

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The Canadian Life and Health Insurance Association (CLHIA) is pleased to provide its comments to the Department of Finance on their proposals to support the sustainability of and strengthen the framework for Federally Regulated Private Pension Plans.

The Canadian Life and Health Insurance Association (CLHIA) is a voluntary association with member companies which account for 99 per cent of Canada's life and health insurance business. The industry provides financial security products including life insurance, annuities (including RRSPs, RRIFs and pensions) and supplementary health insurance to millions of Canadians. This includes managing retirement savings for over 8 million Canadians.

Insurers have paid out **$53.3 billion** in retirement benefits in 2019.

Insurers manage **$309 billion** of Canada's pension assets.

The life and health insurance industry also plays a key role in the Canadian economy, by employing nearly 157,000 Canadians and by providing an important source of stable capital for the federal government through investments and tax contributions.

$8.3 billion in tax contributions

$1.5 billion in corporate income tax

$1.3 billion in payroll and other taxes

$1.6 billion in premium tax

$3.9 billion in retail sales and payroll taxes collected

Investing in Canada

$950 billion in total invested assets

92% held in long-term investments

OVERVIEW

We commend the Department of Finance (the Department) for their pro-active response in initiating consultation with interested stakeholders on how to better promote the security and governance of Canada's pension plans, as well as enable innovative retirement solutions for Canadians. In these uncertain times, it is important to safeguard employee pension plans so that Canadians may retire with confidence, while at the same time allowing for some flexibility to address immediate and unprecedented challenges posed by the pandemic.

With regards to the Department's consultation on Variable Payment Life Annuities (VPLA), CLHIA believes that a well-designed VPLA can be a valuable proposition for defined contribution registered pension plan (DC) and pooled registered pension plan (PRPP) members as a tool for securing post-retirement income. The CLHIA fully supports the concept of a VPLA.

While we have shared our industry's responses to the questions posed, we would be happy to continue the dialogue on the details of the VPLA framework as it continues to be developed to ensure it meets the needs of retiring Canadians and be viable to the stakeholders who will step up to provide competitive solutions.

As we have noted in earlier submissions on this matter, millions of Canadians now rely for their retirement on DC plans, PRPPs, registered retirement savings (RRSPs) plans, registered retirement income funds (RRIFs), and tax-free savings accounts (TFSAs) (collectively the "money purchase plans") that do not guarantee stable lifetime incomes. Widely available and effective retirement income solutions are required for these Canadians as they enter the retirement phase. While there is urgency for secure decumulation solutions, we must get the design framework right, without which we are unlikely to see competitive solutions and choices in the market for robust take up rates.

Our concerns about the proposed approach of requiring that the VPLA be within the registered plan is that it will limit the offering to only the largest of DC plans. Requiring that the ongoing administration of the VPLA be retained by the plan sponsor will also add additional responsibilities to administrators that may lack the expertise. This may lead to sub-optimal outcomes for participants.

The proposed VPLA solution of keeping it within a DC plan or PRPP would, at best, limit the offering to members of the largest of these plans. Based on our experience offering retirement solutions to plan sponsors, we believe only plans with tens of thousands of employees would likely be able to benefit. This is due to the need for a large enough group within a cohort to achieve the beneficial aspects of risk pooling without significant volatility and prohibitive administrative costs. This reality will effectively prevent millions of members of smaller plans, and other Canadians who save through RRSPs and TFSAs, from accessing the benefits of VPLAs. The requirement for VPLAs to be operational within a pension plan may even further curtail large employers that operate multiple DC/PRPP plans from having the scale to offer VPLAs as currently proposed.

The CLHIA in its response to the budget 2019 consultations addressed this specific drawback by advocating for the federal government to expand on the proposed tax legislative changes to enable free-standing VPLAs. This would allow a "pool-of-pools" approach where Canadians can transfer their accumulated DC and PRPP balances to a centralized source responsible for the administration of the VPLA. This would allow for a larger pool of participants to benefit from lower fees per participant and larger diversification of risks that would be expected to reduce volatility of benefits. It would be valuable to extend the eligibility to other savings vehicles, such as RRSPs, RRIFs and TFSAs since not every Canadian participates in a DC or PRPP plan.

It is imperative that the scope of VPLAs be sufficiently broad in order to enable viable risk solutions to be manufactured and managed effectively and competitively. Even those large DC plans that have the scale to offer VPLAs may encounter practical difficulties in being able to balance and manage risks while providing the required degree of certainty of retirement income to plan members, as highlighted in our responses to specific questions on the VPLA framework below.

We believe that the pool-of-pools concept of free-standing VPLAs would reduce or remove all or most of the issues and concerns highlighted below and would provide a meaningful opportunity for market participants to provide new solutions to ensure a reliable level of retirement income security for Canadians.

TECHNICAL COMMENTS

Variable payment life annuities

1. **Are there other timing requirements that could be considered for VPLA actuarial valuation reports? For example, should the frequency of required actuarial valuation reports be linked to a VPLA's chosen funding approach (i.e., PfAD)?**

   CLHIA supports the position that VPLAs should perform actuarial valuations at least every three years which is consistent with DB plans.

   Given the current 'within plan' VPLA proposals, plan sponsors should perform interim testing (using simplified extrapolation techniques) of funding levels at least annually to review if plan benefits require adjustments, as required by the draft income tax proposal. We note that increasing the frequency of valuations and even simplified testing will increase the cost of operation of 'within plan' VPLAs, making them less feasible.

2. **Does the proposed approach for partial annuitization, unlocking, and withdrawal from a VPLA strike an appropriate balance between providing flexibility to members while preserving the risk pooling nature of the VPLA?**

   Yes, the CLHIA agrees with proposals put forward in this consultation. VPLA plan members should **not** be permitted to withdraw funds once in the VPLA, other than as benefits or at the time the VPLA is wound down (for lack of funds and the minimum number of members as required). Certainty over the permanence of the VPLA funds is important for the pooling arrangement.

   Further, the unlocking allowed prior to entering a VPLA and the amount to be transferred to a VPLA, etc., should be flexible to allow retirees to make choices that best meet their needs in retirement.

3. **To allow for earlier VPLA purchases, should members of a PRPP or DC pension plan also be able to enter a VPLA offered by the plan at any time, rather than limiting the option to enter a VPLA to only when members are at retirement?**

   The CLHIA would like to clarify what the Department means by "allow for earlier VPLA purchases"; would this include purchases of VPLAs while members are still in their accumulation phase to lock in a deferred variable annuity?

   We believe members should have the ability/flexibility to acquire VPLAs or add to their existing VPLA (or a free-standing VPLA if that is made possible) from eligible sources, ensuring each enrolment is priced at the then current annuitization rates to ensure fairness. However, it should be noted that allowing earlier purchases of deferred annuities introduces complications from a practical standpoint (for example lack of liquidity to members once funds are contributed to a VPLA and the need to ensure plan members understand the continued variability of their benefits). These may lead to increased tracking and disclosure requirements in plans and add to the operational costs of such plans.

4. Are there any other circumstances where new disclosures could be needed for VPLAs, in addition to what is being proposed?

Clear and informative communication of plan design and risks (including highlighting the influences that cause variability of the VPLA benefit) at the point of election (prior to a member joining the VPLA) would be crucial to allow members to make well-informed decisions. Disclosures should include information on the sensitivity of the VPLA benefit payments to changes in actuarial assumptions (not just experience) as well as investment performance.

Ongoing communication should include detailed annual statements with prescribed disclosures on items, such as, investment strategy, funding levels, and reminders around the variability of the VPLA benefits. Advanced notice of pending benefit changes should also be communicated. Clear and informative disclosures are as important to members at the outset of entering into a VPLA as are the ongoing annual disclosures to VPLA members.

Additional disclosures with regards to a marriage breakdown may also be necessary. This does not appear to have been taken into consideration in the consultation document.

5. What are your views on the proposed requirement for PRPP and DC plan retirees to obtain spousal consent before entering a VPLA?

The CLHIA agrees the VPLA framework should track provincial requirements for other retirement income plans to require DC and PRPP plan members to obtain spousal consent at the time of entering a VPLA through a standardized form that outlines the nature of the VPLA, and risks involved with such a plan, etc.

6. Are there any other portability options that could be considered for VPLA retirees and beneficiaries on plan termination?

CLHIA believes it would be difficult for VPLA plan sponsors to purchase annuities at an individual level from an insurance company that would replicate the level of pension benefits being provided to each retiree at the time of VPLA plan termination. In addition to the proposal for the VPLA framework to provide members with the commuted value of their VPLA benefits on termination, the framework should also consider the choice of group annuities to be purchased from an insurer for the remaining retirees using their aggregate commuted values (available funds). The pricing and benefit of a group annuity would be more consistent with the initial intent of members in allowing for a pooled approach to longevity and investment risk.

The problems with securing reasonable benefits to VPLA retirees on plan terminations is likely to be encountered more often with ‘within plan’ VPLAs as proposed in this consultation (especially smaller plans). This again highlights the versatility of free-standing VPLAs that will have the scale from a pool-of-pools approach to minimize or eliminate the instances of plan termination. Regulatory requirements, as well as dynamic risk management and diversification strategies in place at financial institutions that can offer such free-standing VPLAs will help ensure the continuation of variable benefits to participating VPLA retirees.

7. **What would be an appropriate approach to the calculation of commuted values for VPLAs? For example, should plans be free to choose between different methodologies prescribed in regulation or follow a methodology proposed by the Canadian Institute of Actuaries (CIA) for target benefit arrangements?**

   The CLHIA is of the view that the methodology proposed by the Canadian Institute of Actuaries (CIA) for target benefit arrangements is a reasonable approach. It is possible that the CIA would later recommend an approach specific to this situation. It might be appropriate that the VPLA legislation reflects this potential subsequent change.

   As per our comments to question #2, the CLHIA does not believe VPLA plan members should be allowed to withdraw funds once they are in the VPLA. As such, the calculation of commuted values are unlikely to be needed, other than potentially in the instance of a marriage break-down (although the spouse could be locked into their share of the ongoing VPLA benefits only), on payment of any remaining balance in a guarantee period if the plan provides for an actuarial commuted value, or on plan termination.

8. **What are your views on the PBSA's principles-based approach to administrator's fiduciary duty? Are additional clarifications necessary to ensure that the fiduciary duty principles apply to both the accumulation and decumulation periods?**

   The CLHIA supports legislative amendments which provide a "safe harbour" for plan sponsors offering variable benefit or VPLAs with regard to their fiduciary duty in the decumulation stage, provided the plan sponsor/administrator follows the prescribed standard of care and fiduciary duties. The Department should though recognize the importance and significance of the sponsor/administrator's fiduciary duties given the fact it is the retirees who bear the risk through the variability of their benefits. This can be contrasted with for example a defined benefit plan where much of the risk rests with the plan sponsor/administrator, as the benefits are guaranteed.

Temporary broad-based solvency funding relief for 2021

1. **What are your views on the potential challenges that could be facing federally regulated DB plans in 2021?**

   In general, the CLHIA is supportive of the initiatives being proposed by the Department to provide temporary solvency funding relief to plan sponsors to mitigate the impacts of ongoing pandemic on business operations while balancing the interests of retirees.

Measures to further strengthen the framework for Federally Regulated pension plans

Plan Administrator

1. **What are your views on requiring plan member and retiree representation for all federally regulated pension plan Board of Trustees, for both single- and multi-employer pension plans?**

   No comment

2. **What other approaches could be considered to increase plan member and retiree representation in plan governance?**

   No comment.

Governance Policy

3. **Would it be appropriate to require all federally regulated pension plans to establish a governance policy with the minimum prescribed content? If yes, should the prescribed content align with the CAPSA Governance Guideline?**

   The CLHIA is supportive of a Governance Policy with minimum prescribed requirements to help all parties involved understand their role and responsibilities. The Department should also aim for harmonization of governance policies as in the manner of best practices of the CAPSA Governance Guideline to help ease administration burden.

Funding Policy

4. **To encourage a strategic and transparent approach to funding, should single-employer and non-NC multi-employer DB plans be required to establish and maintain a funding policy?**

   No comment.

Environmental and Social and Governance Policy

5. **In light of the growing international focus on ESG factors in investing, what would be an appropriate approach to encourage pension plans to consider ESG factors?**

   ESG is a growing and evolving area of interest and concern in many circles, including in the context of pension plans. The CLHIA would strongly advise a voluntary approach to encourage plan sponsors to consider ESG factors for their pension plans, in line with the Ontario approach.

6. **What are your views on the relationship between ESG factors and pension plan administrator's fiduciary duty?**

   Decisions made in regard to ESG investing would form part of an administrator's fiduciary duties, as would be the case with other investment decisions.

7. **What are your views on allowing federally regulated pension plans to provide required information electronically to plan members and retirees on a deemed consent basis?**

   CLHIA members are strongly supportive of allowing federally regulated pension plans to provide required information electronically to plan members and retirees on a deemed consent basis. While there is a need for increasing reliance on electronic communications with increased mobility of employees between employment, the Department should consider minimal formalized requirements for employees and plan sponsors/administrators to maintain critical contact details up to date.

8. **What are your views on current legislative requirements to make federally regulated pension plans to provide required communications to spouses and common-law partners? Is it feasible for plan administrators to provide electronic communications to spouses and common-law partners on a deemed consent basis? If not, what other options could be considered?**

   The CLHIA agrees with the concept and is supportive of the need for transparent information (on an as required basis) to spouses and common-law partners on a deemed consent basis. The Department needs to consider what contact information would be appropriate to collect and use for communication with spouses and common-law partners, taking in account privacy considerations.

CONCLUSION

The industry greatly appreciates the opportunity to provide comments on how best to ensure Canada's retirees need for secure retirement income can be made possible and serve the needs of Canadians for many years to come. We commend the government for examining these topics and considering our comments as they move forward with this important policy initiative.

The CLHIA looks forward to continuing to participate in this consultation process and would appreciate the opportunity to share our experience and expertise through a subsequent meeting with officials.

Should you have questions regarding any of our comments, you may contact Noeline Simon (nsimon@clhia.ca).