



Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

Submission

by the

Canadian Life and Health Insurance Association

to the

Government of British Columbia

on

Savings for Retirement

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I: INTRODUCTION

Canada's retirement system is internationally recognized as a success. The recent Melbourne-Mercer Global Pension Index ranks Canada's pension system among the top four worldwide.¹ But gaps in retirement-focused savings remain for middle income earners, and corresponding refinements of our private pension regime to address these shortfalls are needed.

As service providers to many private sector pension and retirement savings arrangements, Canada's life and health insurance companies have direct experience and knowledge of the strengths and challenges of our "three pillar" retirement savings and income system, and much to contribute to discussions of pension income adequacy.

In this paper, we review current savings gaps, discuss principles that should form the basis of a robust and efficient pension system, and consider the benefits and challenges of current proposals in light of both these gaps and principles. We recommend simple legislative changes that would quickly and efficiently facilitate expanded access to flexible, competitive, retirement arrangements for all working Canadians.

Canada's existing pension regime is fundamentally sound but the scope of public elements was never intended to exceed basic income replacement. Small legislative and regulatory changes can leverage existing private sector infrastructure and expertise to increase coverage, adequacy and the security of supplementary retirement incomes for Canadians, at costs competitive with public plans. Moreover, these changes can be implemented quickly, and avoid the significant fiscal risks of expanding public pension systems or creating new government-sponsored arrangements.

More broadly, Canadians need to play an active role in building their retirement prospects. The attached CLHIA report, entitled *Saving More for the Future: An*

¹ Melbourne Mercer Global Pension Index. 2009.
<http://www.mercer.com/globalpensionindex>



Achievable Goal for Canadians, identifies simple ways to support behaviours that can help deliver the retirement resources and lifestyles we all seek.

II: THE PENSION GAP

Canada's retirement system is built on three complementary elements:

Old Age Security and the Guaranteed Income Supplement are state programs granted to all Canadians based on age, residency, and income level, and are financed out of general government revenues. They are intended to provide guaranteed levels of income to meet the very basic of living expenses.

The Canada Pension Plan and Quebec Pension Plan are compulsory, employment-based programs that provide core income security up to 25% of wages, to the national average income of \$47,200. Contribution rates are 4.95% for both employees and employers.

Additional employment-based savings are meant to augment public plans to provide "adequate" retirement income. They consist of workplace retirement plans such as employer-sponsored pension plans and Group Registered Retirement Savings Plans (GRRSPs), as well as individual tax-assisted savings.

As the B.C. Pension System Review consultation paper correctly points out, studies show that a significant proportion of Canadians will not be able to maintain their lifestyles in retirement. Since public programs are designed to replace pre-retirement income for wage levels up to the average industrial wage and nothing above that level, individuals earning more than \$47,200 in 2010 will see declining levels of public support. Indeed, given the clawback of OAS benefits where income from other sources exceeds \$66,335 (2009 threshold), the declining replacement level from public programs becomes quite pronounced. The following table reflects the maximum income replacement rates from public programs as pre-retirement income varies:



CPP/QPP + OAS, Single person, maximum, 2010 ²				
Pre-retirement income	\$30K	\$50K	\$80K	\$100K
Replacement Rate	46%	35%	22%	17%

While the required income replacement ratio in retirement will be contingent on many factors, and public programs provide comparatively high income replacement levels below the \$30,000 threshold, the table shows that the replacement rate provided by public programs for incomes from \$30,000 to \$100,000 leads to a significant need for supplementary savings.

Similarly, participation in supplementary workplace-based retirement plans is dramatically skewed. Within the public sector, 80% of workers participate in defined benefit (DB) pension plans paying inflation-indexed benefits that typically replace 60-70 per cent of pre-retirement earnings.³ By contrast, only 50 per cent of private sector employees have access to employment-based retirement arrangements, and this participation is primarily by employees of larger enterprises. Statistics Canada data indicate that more than 80 per cent of employees of organizations of 500 or more employees have registered pension plans, compared to just 26 per cent for organizations of 100-499 employees, and only 2 per cent for those working in businesses with fewer than 50 employees.⁴

Increasing employee mobility, the reduced role of collective bargaining in the Canadian economy and continuing employer concerns about the financial and legal liabilities associated with defined benefit pension plans have driven down the prevalence of defined benefit plans in the private sector. Just as defined contribution

² BMO Retirement Institute. 2010. Special Report: Saving for retirement: One size does not fit all.

http://www.bmonesbittburns.com/personalinvest/retirementyourway/pdf/Saving_for_Retirement_E_final.pdf

³ Statistics Canada, 2008. Federal Public Service Retirements: Trends in the New Millennium. May. Catalogue no. 11-621-M-No. 068.

⁴ Statistics Canada, CANSIM, table 281-0042 for employees and 280-0010 for RPP members.



plans have become more common, non-pension savings arrangements such as Group Registered Retirement Savings Plans have grown in significance, in large part because of their consistent national regulatory regime and greater flexibility in employer funding. Private sector pension participation is now estimated at about 23 per cent nationally, with participation in alternative arrangements such as Group RRSPs estimated to be a further 28 per cent.⁵ Still, a significant number of Canadian workers, particularly at middle income levels, do not participate in employer-provided retirement programs.

Finally, Canadians individually have access to a robust and comprehensive set of tax-assisted savings vehicles, generally through registered retirement savings plan (RRSPs). However, it is clear that Canadians are not availing themselves of this option to the full extent. Only about the third of those eligible for RRSPs actually choose to use this savings vehicle and only 6% of the available contribution room has been used since 1991. Therefore, policies to encourage more tax-assisted savings at the individual level must also be explored.

III: GUIDING PRINCIPLES FOR PENSION REFORM

The CLHIA believes that any changes to the Canadian pension system must be made within the context of set policy principles. In our view, these principles are:

Providing for basic needs

The retirement system should ensure that all Canadians receive a level of income that meets their basic needs in retirement. This, correctly, is the goal of the first two pillars of Canada's pension system and the CLHIA believes that the current system is broadly successful at achieving this.

Incentives to save

⁵ Baldwin, 2008. Canadian Public Policy: The Shift from DB to DC Coverage: A Reflection on the Issues. November. Vol. XXXIV, Supplement.



The retirement savings system should encourage and enable all Canadians to save enough in order to approximate their pre-retirement standard of living during retirement.

Private sector participation

The retirement system should, as much as possible, rely on the third pillar programs to move Canadians from simply meeting their basic needs to supporting their desired retirement lifestyle.

Choice

The retirement savings system should ensure that Canadians have flexibility in determining how they save for retirement. This choice should encompass both the ability to choose the appropriate vehicles for their savings (employer pension plans versus other tax-assisted instruments) as well as who the ultimate provider and administrator of their savings is.

IV: A BETTER ALTERNATIVE

The CLHIA proposes a series of changes to the pension regimes in Canada and the provinces that, cumulatively, will meet all of the principles laid out above. These proposals and rationale are outlined in more detail in our attached policy paper - *Saving More for the Future: An Achievable Goal for Canadians* - and so are presented in summary form here.

1. Improve the take-up rate by individuals for tax-assisted retirement saving:

Individual Canadians have a great deal of choice about how they access financial products, services and advice. There are a multitude of savings vehicles and sales channels currently available to Canadians that can meet any desired savings need a Canadian may have.



That said, as the B.C. Pension Systems consultation paper correctly points out, tax-assisted savings vehicles are not being fully utilized. As a result, there are many Canadians not saving enough in order to sustain pre-retirement standards of living into retirement.

The CLHIA believes that there are some minor changes that could significantly increase individual savings behaviour:

1. amend tax legislation to expand the definition of income eligible for tax-assisted savings to include all income of an individual from office, employment, business and property
2. extend the date at which Canadians must draw down on their tax-assisted savings by two years to the end of the year they turn 73
3. allow individuals to apply their unused RRSP contribution room to DC pension plans
4. federal government to study whether to shift from an annual 18% contribution for RRSPs and DC pension plans to a lifetime maximum amount

Further, to educate Canadians about the importance of saving for retirement and to give them the tools to make responsible decisions, the CLHIA paper recommends that governments develop a national program, supported by a central portal of information and educational tools. This should be augmented by a national advertising campaign to promote savings-savvy behaviour.

2. Provide universal access to workplace savings plans:

The CLHIA notes that there are gaps in today's Canadian workplace retirement system. The most notable is between the coverage of public and private sector employees, the former having a coverage ratio of close to 90% while the corresponding private sector ratio is around 50%.



Canada currently has in place the infrastructure to implement cost-effective plans in most workplaces. The Canadian life and health insurance industry has many decades of experience offering DB, DC and Group RRSP plans for employers. However, there are impediments to extending workplace plans further. We would propose the following five-pronged approach to addressing the structural issues that are impediments to greater take-up of retirement savings at the workplace.

1. Amend tax and pension legislation to permit Defined Contribution – Multiple Employer Pension Plans (DC-MEPPs)

We propose the creation of a new kind of MEPP, that would be sponsored and administered by regulated financial institutions and would be a DC plan. In order to accomplish this, legislation that requires the employer to act as plan sponsor would be eliminated. DC-MEPPs would remove almost all of the administrative and compliance burdens that inhibit many smaller employers from offering pension plans to their employees.

A key benefit of this arrangement would be that it would overcome the barrier to universal access, namely the requirement for a unique employer-employee relationship. The added benefit would be that single plans for multiple workplaces would achieve economies of scale currently available to only the largest pension plans.

Research carried out for governments by the Jack Mintz study clearly indicates that scale can be very important in reducing the cost of operating pension plans. Present DC arrangements in Canada routinely operate with costs in the 40-70 bps range⁶. A DC-MEPP model could be expected to have similar cost levels.

A question has been raised about how regulated financial institutions can take on the roles of both sponsor and administrator of a plan. Currently, any employer that

⁶ Statistics Canada, 2008. Federal Public Service Retirements: Trends in the New Millennium. May. Catalogue no. 11-621-M-No. 068.



offers a traditional pension plan deals with the twin accountabilities of their obligations to shareholders as sponsors of the plan, and their fiduciary obligations to plan members as the legal Administrator of the plan. This situation is well understood and there are well established processes in Canada to ensuring the proper separation.

The industry believes that present requirements under the various insurance acts and the requirement to act in the best interest of clients, is sufficient to deal with any potential conflicts.

However, if it were felt necessary for an additional third-party governance mechanism, the industry is ready to discuss this issue further with government officials.

2. Amend tax and pension legislation to enable auto-enrollment in workplace group retirement plans:

The CLHIA proposes that workers be automatically signed up for their employer's retirement plan. However, we would provide them the ability to opt-out, thereby preserving all Canadians' right to chose how they prefer to save for retirement. Such auto enrollment schemes in the United States have resulted in dramatic improvements in the percentage of workers who are covered by a retirement plan.

3. Remove any pension and employment legislative impediments to auto-escalation in workplace retirement plans:

The auto-escalation option would allow for the amount that employees contribute to their retirement plan to escalate from a low starting base over time. For example, such a system could start members at a base contribution rate of pay, and automatically escalate it by a constant amount as the age and income of the individual increases over time. As with auto-enrollment, an employee could override the auto-escalation should he or she wish.



4. Require all workplaces with greater than 20 employees to have a workplace retirement plan:

The life and health insurance industry recommends that all employers with twenty or more employees be required to offer some form of workplace retirement plan. Such a requirement and threshold would ensure that roughly 80% of Canadian workers are covered by a workplace retirement plan. While smaller businesses would not be required to offer a plan, we feel that many of the smaller firms would offer a retirement plan to their employees and ultimately far greater than 80% of Canadians would be covered. With the existence of group RRSPs and DC-MEPPs, an employer could offer retirement plans at little or no cost aside from payroll deduction.

5. Amend tax legislation to ensure that employer contributions to Group RRSPs are locked in:

Group RRSPs represent an increasing proportion of workplace plans. Some are structured where only employees contribute, while others have an employer contribution component as well. Given that under such arrangements, withdrawals can be made at any time, some employers have voiced a concern about whether the money they are contributing will stay in the plan until retirement. Accordingly, we recommend that a lock-in provision for Group RRSPs be developed, at least for the employer share, similar to what exists for DC pension plans and Quebec Simplified Pension Plans.

V: Other Proposals

A number of governments and interest groups have identified other possible pension plan options for consideration. These options all attempt to improve coverage and adequacy but in our view are not as attractive as those that we have proposed above. All involve greater direct government involvement with increased fiscal exposure and risks. We believe that consistent with the three pillar model that has



served Canada well, governments should empower the private sector to increase savings opportunities for Canadians.

Let us look more closely at these other proposals.

Increasing CPP/QPP

One possibility would be to increase substantially the existing DB premiums and benefits of the CPP program. A doubling of premiums has been suggested. While we agree that governments must assess the levels of CPP/QPP from time to time to determine whether they continue to contribute effectively to meeting basic needs in retirement, a doubling of present levels would have significant impacts on these plans themselves and on employers and employees. First, if premiums were doubled tomorrow, the doubling of payments would not occur for over 30 years, assuming no government subsidization. Furthermore, a mandatory doubling of premiums to be paid by employers to 9.9% in this economic environment would certainly be problematic for many employers, particularly small business, and would discourage them from hiring or retaining existing employees. As Minister Hansen noted, an expansion of the CPP may not sit well with struggling companies who would be forced to increase their payroll taxes. "If we were to try to implement this today (a compulsory plan), we would get great pushback from the private sector, who basically could not afford an increased burden of an increased payroll tax. If it's a voluntary program then that helps mitigate that problem."

A Government Sponsored DC Plan

A second proposal is to establish a government sponsored DC plan that would offer a large-scale pension plan option to all workers. The proposal normally is accompanied by a recommendation for an auto-enrollment provision, with an option to opt-out, presumably at the level of the employer.

While the objectives of this proposal are similar to those of our DC-MEPP proposal, we believe that there are many more dangers related to a government sponsored



option. First, we believe proponents severely underestimate the costs and time it will take to set up such a plan. On the cost side, massive expenditures will be needed to replicate the infrastructure that already exists in the financial sector (administration, individualized record keeping, call centres, marketing, investment management, etc.). History has shown that those who have gone this route have not fully appreciated the magnitude of these costs, particularly early on in the establishment of new government plans. The recent experience of the United Kingdom in this very same area has been instructive. The United Kingdom has announced the expected costs associated with operations of the National Employment Savings Trust (NEST). In addition to the 30 basis point costs of ongoing administration, there will be a 200 basis point levy on each contribution for an indefinite period to cover start-up costs. This will make the NEST costs higher than the average occupational plan in Britain and well above large scale plans in Canada. One former UK Treasury advisor, Ros Altmann, noted in the Daily Telegraph: "The idea of taking away 2% of people's money before they even start saving strikes me as high, but the costs of administering tiny pots of money for decades is also high. Call me cynical, but this scheme has disaster written all over it".

The UK experience is also instructive in how long these government plans may take to start running. The NEST is expected to start in 2012, even though the UK government announced its establishment in 2005! No such delays will be needed for DC-MEPPs where the infrastructure and expertise are in place.

Another disadvantage of a government sponsored plan is the implied financial liability of the government or governments. It is true that the proposal is for a defined contribution plan. However, Canadians will believe that, if returns fall short of expectations, the government will be there to "top up" the plan. Notwithstanding possible statements by the government at the time of set up, the pressure for governments to step in during difficult times (as we have seen recently elsewhere during the financial crisis) will be enormous.

Some proponents of a government sponsored plan believe that such a plan could co-exist with DC-MEPPs and other industry offerings. This would be difficult,



particularly if there is a supporting automatic opt-in provision to the government plan. Why would an employer choose to opt out of a government run plan if he or she or his or her employees believe that there is an implied backstop? Similarly, would there be a legal liability for the employer by opting-out if results were less than favourable in the private sector plan? One could easily see how over time the government sponsored plan would develop into a de-facto monopoly of workplace savings for retirement. This concentration of assets with one organization would lead to significant implications if there were poor performance, and little hope for innovation and cost efficiency.

In order to deal with these perception concerns, some believe that the government could establish an independent board to operate free from government influence. However, in our view, if the plan is established by government with a legislative requirement of opting into that plan, it will be inevitably seen as a government plan, and any behaviour and results of that plan will reflect on the government or governments that set up the plan.

A DC Top-up to the CPP/QPP

The proponents of a CPP/QPP top-up believe that some of the cost and timing issues of a government sponsored plan can be reduced by attaching the new DC government plan to the present CPP structure. We believe this largely not to be the case and tying it to the present Canadian success story has its own set of problems.

First, with respect to costs, there is very little savings that would occur to have the DC plan run by the CPP/QPP. While there may be some investment management overlap, the present Canadian Pension Plan Investment Board (CPPIB) has no experience or infrastructure to run a DC plan that would need to provide education, advice and service to its DC customers. As Mr. Ian Dale of the CPPIB stated before the House Finance Committee on March 23, 2010, "the way we are currently set up, we're not equipped to do that. That would be a significant departure for us should policy makers ask us to do that kind of thing." Therefore, there appears to be little cost or time savings that will occur in adding a new DC plan to the CPP/QPP.



Indeed, in terms of all the disadvantages for a government sponsored plan that are described above, we believe that they also apply to the CPP/QPP top-up. In fact, the implied government liability would even be stronger if the DC plan were associated with the DB CPP/QPP. The opportunity for confusion in the minds of the public between the present basic DB plan and a new DC plan is enormous, creating even more demands for government intervention if returns fall short of expectations.

The CPP/QPP is a great Canadian success story in its present form and is recognized as such domestically and internationally. We should not jeopardize that reputation by adding onto it a program that it has not been set up to do.

VI: CONCLUSION

We commend Governments throughout Canada for their efforts to enhance savings of Canadians for retirement. We believe it is time to have this debate and to seek solutions.

Regulated financial institutions already offer a wide range of services to pensions and retirement savings plans in Canada. Achievable legislative and regulatory reforms can lead to substantial increases in coverage and adequacy of retirement savings. We believe that this would be best achieved by leveraging the infrastructure and demonstrated expertise of the private sector.

The life and health insurance industry is ready to play its role in supporting governments, businesses and individuals in reforming the retirement savings system so that all Canadians can meet their basic needs and enjoy an adequate lifestyle as they move into their senior years.



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ABOUT CLHIA

Established in 1894, CLHIA is a voluntary trade association that represents the collective interests of its member life and health insurers. Our members account for 99 per cent of the life and health insurance in force in Canada and contribute to the financial well-being of millions of Canadians by providing a wide range of financial security products.

The industry protects 26 million Canadians, as well as 19 million policyholders in other countries around the world, with products such as life insurance, annuities, RRSPs, RRIFs, disability insurance and supplementary health insurance. It also administers two-thirds of Canada's pension plans, primarily Defined Contribution (DC) plans for small and medium-size businesses.

In 2008, Canada's life and health insurers paid out \$58.4 billion in payments to policyholders and beneficiaries, of which \$27.5 billion was annuity payments.