Paying pensions today, preserving pensions for tomorrow.

Letter re: Consultations on Enhancing Retirement Security for Canadians (the "Consultation Paper")

We thank you for providing Canadians with an opportunity to provide feedback on the Canadian retirement income system and in particular its third pillar – employment pension plans.

With net assets of over $20 billion, OPTrust invests and manages one of Canada's largest pension funds and administers the OPSEU Pension Plan, a jointly sponsored defined benefit (DB) plan with over 92,000 members and retirees. OPTrust recently launched OPTrust Select, which offers a secure retirement solution at a moderate cost for Ontarians in the broader public service and nonprofit and charitable sectors who do not currently have access to workplace pension plans.

We would like to begin by commending the Government of Canada for its leadership in the reform of the second pillar of the Canadian retirement income system – the Canada Pension Plan (CPP). With the enhancements made to CPP, middle income Canadians can look forward to a more secure retirement in the future.

However, we agree that further reforms are needed to strengthen the third pillar.

Employment pension plans and particularly DB plans have been in decline for the last two decades for many reasons, including the ones set out in the Consultation Paper. If employers provide a group plan at all, it is most often a defined contribution plan or a group RRSP. These plans do not typically offer the same level of security as DB plans because investment and longevity risks lie with the individual.

A new kind of challenge is posed by the emerging 'gig' economy. We understand that in the very near future, fifty percent of the workforce will be self- or 'serially' employed. Many older Canadians also participate in the 'gig' economy by necessity – retirement at age 65 is not an option for a growing number of Canadians.

DB plans carry risks as well, as we saw with the Sears insolvency. Yet the Canadians we talk to still want the security that well-managed DB plans offer. The security of a regular retirement income impacts retirees' quality of life. Perceptions govern behavior – if people are worried about outliving their savings they tend to spend less, resulting in a lower standard of living. This lack of certainty affects not only the retirement experience of individuals; the Canadian economy will be impacted if large segments of the population reduce spending because of their fear of outliving their money.

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We believe Canada needs innovative retirement income solutions that reflect changing socio-economic challenges. While the regulation of private pension plans is largely a provincial matter, the federal government is responsible for the taxation system, which drives many aspects of pension plan design.

It is also responsible for the design and administration of both other pillars of the Canadian retirement system – the second pillar, CPP, and the first pillar, the two basic retirement income programs (Old Age Security and the Guaranteed Income Supplement). Consequently, the federal government is uniquely positioned to start a conversation about the third pillar. In this letter we identify three areas where we believe an innovative approach is required: financial literacy, pension regulation and tax reform.

Financial Literacy

In our experience the level of retirement literacy among Canadians is very low. Canadians do not know how much they need to save for retirement; nor do they understand the benefits and risks of the different types of retirement savings vehicles. In our DB world, plan members are not aware of the risks inherent in a plan's funding requirements: since there is no requirement that employers keep plans funded on a wind up basis at all times, an employer insolvency can lead to pension benefits being reduced if the plan is underfunded.

The answer to this type of challenge is not to give up on the DB model as an option for providing effective retirement security. We continue to believe a retirement vehicle that offers risk pooling is the best mitigant for the key risks facing individuals in retirement – investment and longevity risk.

Consumers of all types of retirement products need to understand the risks and rewards so they can take appropriate measures to protect themselves. We see the promotion of financial literacy as a critical component in the emergence of a new, less paternalistic, approach to retirement security. In this environment, it will be incumbent on individuals to take ownership of their retirement planning.

We commend the federal government for the steps it is taking to promote financial literacy and urge an expansion of initiatives in this critical area. OPTrust would be happy to help government develop creative ways to engage with Canadians on retirement issues.

Modernizing Pension Regulation

The recent rash of high-profile insolvencies highlights a basic design flaw in the model of the single employer DB pension plan: the lifespan of an enterprise is typically much shorter than the pension obligations it assumes, which are very long. This inherent risk cannot be resolved through the easing of solvency funding requirements (in fact that could have the opposite effect) or the imposition of additional governance requirements on federally-incorporated corporations. Reforms to bankruptcy laws may help individual members but will not address the systemic issues that caused the problem in the first place.

We think a more radical approach to reforming pension regulation is needed to address the challenges of the Canadian workforce in the 21st century. The last major round of pension reforms took place about 30 years ago. The reforms dealt mainly with DB plans and adopted a very prescriptive approach to pension regulation. Since that time pension legislation in most jurisdictions has become even more prescriptive.

We believe it is time to revisit this state of affairs. A more principles-based approach would promote innovative plan designs better suited to the current socio-economic environment. A major barrier to meeting Canadians' pension needs is the slow and piecemeal pace of reform. We understand that reform tends to move slowly because governments must balance competing interests and no solution will satisfy every constituency. We suggest that rather than seeking consensus on 'one size fits all' solutions, the government should establish a framework – a set of principles – within which employers, unions, employees and advisors can negotiate their own solutions for pension matters.

A critical component of a less highly regulated approach to pension regulation is education. Canadians need information about their retirement savings options (including the risks) so they can advocate for themselves and make good decisions. This is why we are strong proponents of financial literacy.

While regulation of private pensions is a provincial matter, we encourage the federal government to consider how it can build on the momentum created by the CPP expansion by beginning a conversation with the provinces on the modernization of the third pillar of the Canadian retirement system. Again, we would be pleased to participate in such a conversation.

Tax Reform

A major driver of pension plan design is the impact of the tax system. The last significant pension tax reforms took place almost 30 years ago and, like minimum standards legislation, were shaped by a pension system dominated by DB plans. As noted above, however, the pension landscape has changed dramatically since the early 1990s.

Many factors contributed to these changes, including severe market events and the 'low for long' economic environment which wiped out surpluses and increased required contributions. The complex regulatory system and accounting changes requiring plan sponsors to reflect pension obligations on their balance sheets also had an impact. One result of the changes is the decline in DB plans and their replacement with capital accumulation-type plans (CAPs), such as defined contribution plans and group RRSPs. As noted above, the tax rules were developed in a DB environment. We think a review of the tax treatment of CAPs in light of the very different pension and socio-economic landscape would be desirable.

Other changes in the socio-economic environment also point to the need for a review of the rules. Increasing mortality has highlighted the need for ways to manage longevity risk. This is particularly important since more and more Canadians are being forced to rely on individual savings through CAPs

which, along with longevity risk, also bring investment risk. Finally, as noted above, the number of self-employed and serially-employed Canadians is growing rapidly. The current system is not designed to accommodate these changes.

Various proposals exist to address longevity risk, such as increasing the age to receive income from public plans to 75. We support these proposals but suggest that a deeper dive into the pension tax system is necessary, and that a review of the pension tax system should form part of a comprehensive examination of the third pillar.

We realize that our recommendations are far-reaching, but we feel very strongly that we must at least begin a discussion about modernizing the private pension system in Canada. For the reasons outlined above, we think the federal government is well-positioned to take a leadership role in such a discussion. In Appendix A we propose an innovative concept for bringing all levels of government and the pension industry together on a more permanent basis. We would be pleased to discuss the concept further if it is of interest.

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APPENDIX A

A PROPOSAL TO ESTABLISH A GOVERNMENT-SPONSORED PENSION POLICY CENTRE

The Issue

- Canada's retirement income system must deliver adequate retirement income to Canadian workers while facilitating Canada's competitiveness in the global marketplace. The 2008-2009 financial crisis revealed cracks in the 'three-pillar' model of retirement savings adopted by Canadian governments in the 1960s, although there was no agreement among experts as to the scope of the problem.
- Almost a decade after the crisis there is still a lack of consensus within the industry on how big the problem is (or whether there is a problem) and what the appropriate solution is. In any case, the fact that pensions continue to make the headlines indicates that the Canadian public is anxious about the issue.
- Governments have taken various steps to respond to Canadians' concerns. The principal change after 2008 was the introduction of the 'pooled registered pension plan' (PRPP), a type of group capital accumulation plan administered by financial institutions. All Canadian jurisdictions have either implemented or are in the process of implementing the PRPP.
- A second proposal was the enhancement of the Canada Pension Plan (CPP). The Harper government considered but ultimately rejected CPP expansion. The Wynne government in Ontario, which strongly supported an enhanced CPP, began to implement its own version, the Ontario Retirement Pension Plan (ORPP).
- The subsequent Trudeau government supported CPP expansion. An agreement in principle to a phased-in CPP enhancement was reached by all provinces, and implementing legislation received royal assent in December 2016. While this is a positive development, CPP has always been only one leg of a three-legged stool – it will not provide adequate income to many Canadians on its own. A robust occupational pension system is also required, as was intended when CPP was established.
- The adequacy of the retirement income system is, and should be, a matter of critical importance, not just to individual Canadians who are worried they will not be able to save enough for retirement, but to every government in Canada. The rates of consumption of retired Canadians will directly affect the overall health of the Canadian economy in the future.
- Solutions to pension issues remain complex, involving different levels of government and many stakeholders with strong ideological preferences. By definition, solutions require a long-term approach – far longer than the mandate of any one government.
- All of this points to a need to develop innovative, co-ordinated, pan-Canadian and to the extent possible, de-politicized solutions to retirement savings policy challenges.

The Issue

- The proposal is to establish a special-purpose, arms-length, federal-provincial agency to provide policy input on retirement system issues on an ongoing basis: the Canadian Retirement Income Security Agency (CRISA).
- CRISA would have no decision-making authority and would operate as a pan-Canadian non-regulatory body, similar to the Canadian Association of Pension Supervisory Authorities.
- The establishment of a joint federal-provincial agency with a mandate to critically assess proposed solutions to be implemented on a pan-Canadian basis (as opposed to a regional basis) would provide a framework in which co-ordinated solutions to challenges facing the Canadian system could be developed. CRISA could also serve as a central repository of information on the Canadian retirement system over the long term for academics, governments and the general public.
- CRISA could bring the various stakeholders together and provide a neutral forum for discussion of retirement issues, and consensus building on some of the basic areas of disagreement.
- CRISA would not provide an immediate solution to the pressing financial problems facing governments due to chronic pension plan underfunding (particularly in the broader public sector). However, in the long term the agency could serve as a foundation for a stronger retirement system by helping governments identify problems before they reach crisis proportions.
- There is a tradition in Canada of creating pan-Canadian or regionally-based agencies that are in effect joint federal/provincial initiatives to further specific goals. Examples include the Canada Foundation for Innovation (funds scientific research) and the Atlantic Canada Opportunities Agency (promotes economic development in the Atlantic provinces). CRISA would have unique features but would be consistent with the tradition of promoting a co-ordinated approach.

Why Establishing the Agency Would be Good Public Policy

- **Retirement security issues are complex and long-term in nature**. Practitioners in the pension industry would agree that the problems with the system are complex and technical and require a long-term approach. Governments have limited resources and technical expertise. A group of neutral dedicated experts with credibility in the industry is needed to analyze the issues, determine which reforms are needed, make recommendations to governments and help facilitate changes. The establishment of CRISA to do the 'heavy lifting' on pension reform would free up governments to devote time and effort to other issues. However, the ultimate decisions on any reforms would still rest with government.

- **Under federalism, problems with the retirement income system require multi-jurisdictional solutions.** Retirement security issues cut across provincial/federal lines and across different governmental bodies within the various levels of government. To even discuss the retirement income system as a whole, it is necessary to meet with many government departments at both the federal and provincial level.
- **A permanent agency could serve as the repository of data on the retirement income system.** CRISA could monitor the Canadian retirement income system and report to its sponsors. Currently there is no single source for comprehensive data on the retirement system, which may be one of the reasons there is no agreement on solutions. A permanent agency could serve as a central repository of information on the Canadian retirement system over the long term for academics, governments and the general public, taking this function over from Statistics Canada.
- **A permanent agency could represent Canada in the global marketplace.** In a world economy, occupational pension plans are not just a local or national issue. A federal agency could ensure that all levels of government in Canada are aware of the latest international developments, monitor their impact on Canada both as a whole and on a regional basis, and develop co-ordinated and timely proposals for further reforms as required. The agency could also be the face of the Canadian retirement system on the international scene (for example, at OECD).
- **CRISA could serve as a neutral forum for debate among stakeholders.** The agency would serve as a nonpartisan political forum for discussion among pension experts in the public and private sectors where controversial issues could be addressed, analyzed and debated at arm's length from any one government. CRISA could 'take the heat' for unpopular proposals, serve as a lightning rod for debate on controversial public policy issues and use 'trial balloons' to gauge popular support for reforms.
- **The establishment of CRISA would raise the profile of the retirement industry by putting the retirement system on the map on a permanent basis.** A permanent agency, making regular reports to government, would keep retirement issues in the public eye, even when there is no immediate crisis (and no press coverage).
- **The creation of an agency with specific responsibility for retirement income could serve as a point of contact with other agencies in Canada that deal with related issues.** There is a constellation of public policy issues relating to Canada's aging population. Along with retirement security, issues such as healthcare will be critical to Canada's economic and social performance in the next few decades. CRISA could serve as the representative of or point of contact for the retirement system in more broad-based policy discussions and debates involving other sectors.

Main Features of The Agency

The exact features of the agency would be worked out among the governments. Some initial thoughts are set out below.

- CRISA would be a joint federal and provincial initiative on par with and generally modelled on the Canada Pension Plan Investment Board in that federal and provincial representation would be built into the governance structure.
- It would be structured as a non-share capital corporation.[1] The Ministers responsible for pensions at the federal and provincial level would be members of the "Council of Ministers."
- There would be an independent nominating committee selected by the Council of Ministers. The committee would recommend to the Council of Ministers at least twice as many candidates for the board of directors of CRISA as there are vacancies, including at least two nominees who could fill the role of non-executive chair of the board. The board, including the non-executive chair, would be selected by the Council from the candidates so nominated. The Board would be accountable to the Council with primary accountability starting with the chair of the Council from time to time.
- The CRISA board would select the CEO.
- CRISA staff would be relatively small, with much research contracted out.
- CRISA would work with all levels of government and various agencies within each level to develop a co-ordinated approach to retirement security in Canada.
- CRISA would initially be funded with seed money from the federal government and then the agency would develop a cost-sharing structure. It is contemplated that it would operate with a budget of $5-8 million. Ideally, CRISA could develop a consulting business (e.g., to emerging countries interested in establishing pension systems) and would generate some of its own funding.

CRISA would not:

- Replace existing pension agencies or preclude provincial policy initiatives – in fact, reference to expertise developed provincially would be encouraged
- Take away existing powers or functions of any government or agency, or
- Take public positions in opposition to those of its members.

Mandate of The Agency

The mandate would be set by the Council of Ministers. Some initial thoughts are set out below.

- CRISA would derive its authority to co-ordinate policy initiatives from, and be accountable to, the Council of Ministers through the Chairman of the Council from time to time.
- CRISA could assist in the development, co-ordination and implementation of pan-Canadian, provincial or regionally-based solutions, depending on the requirements of its members.

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[1] This is the point of difference with the governance structure of the Canada Pension Plan Investment Board, which is a share capital corporation. Given the proposal functions of this entity, it seems unnecessary to establish it as a regular corporation.

- CRISA would have the technical knowledge to provide meaningful, neutral input on complex public policy and economic issues.
- CRISA could serve as a forum for discussion on current and topical issues (such as CPP expansion) and could facilitate the implementation of special projects if so requested by the membership.
- CRISA could be charged with monitoring the Canadian retirement system, collecting relevant information and issuing periodic reports to its members and the general public.
- As a permanent entity, CRISA could serve as a central repository of information on the Canadian retirement system over the long term. It could work with Statistics Canada to ensure that Canadians have access to meaningful information about the retirement landscape.
- CRISA could undertake research, monitor international developments and consider their impact on the Canadian system and, with the approval of Council, represent Canada in global dialogue on retirement income issues.