

FILLING THE DC VOID

Regulators are turning their minds to defined contribution pension plans, but will they turn employers away from offering them by imposing too many rules?

The Ontario government's announcement in its April budget that it will be addressing the regulatory framework related to defined contribution pension plans has done little to quell the debate about whether modernization and expansion of the existing rules is necessary or desirable.

Those in favour say that, as defined contribution plans continue to grow in popularity, sponsors, administrators and pensioners need more direction than the Pension Benefits Act — formulated in an era when defined benefit plans were all that existed — provides.

"Everyone in the DC community recognizes that our pension legislation was written with DB plans in mind and that the growing presence of DC plans requires governments to be more focused on them," says Ron Sanderson, director of policy-holder taxation and pensions at the Canadian Life and Health Insurance Association.

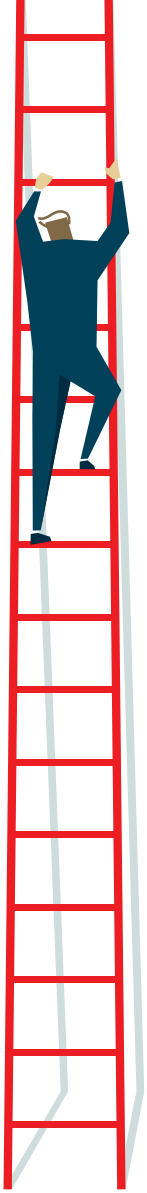
Most glaringly, the legislation doesn't address the payment of periodic benefits from a defined contribution plan when a member is terminated or retires. Members must transfer the funds either to

a designated retirement saving plan or use them to purchase an annuity. That's despite the fact that, since 2005, the Income Tax Act has allowed defined contribution plans to pay variable benefits on retirement.

"Increasingly, people are asking why they can't have other options open to them," says Kathryn Bush, a pension lawyer at Blake Cassel & Graydon LLP. "So decumulation is an area where we really do need legislative help."

Pensioners, for example, could benefit from retaining their accounts in their employer's plan and having variable benefits paid directly from it because investment fees would likely be lower than those payable from a personal retirement savings vehicle. They might also benefit from the investment expertise associated with the employer-sponsored plan.

By Julius Melnitzer



“Right now, the approach is a very paternalistic one where retirees are being left to their own devices,” says Jordan Fremont, a Toronto-based pension lawyer with Hicks Morley Hamilton Stewart Storie LLP, a labour and employment law firm. “What is being considered is greater support for plan members and a legislative framework designed to maximize the outcome for them.”

The Ontario government has yet to proclaim a 2015 budget bill amending the Pension Benefits Act to allow for payment of variable benefits directly from a defined contribution pension plan, pending the release of implementing regulations. In its most recent budget, however, the government affirmed its intention to promulgate such regulations and examine new approaches to decumulation.

“No details were provided, although the government stated that it would engage with the federal government, the financial services industry and pension experts to explore new avenues for Ontarians to manage investment and longevity risk, including during decumulation and otherwise, to improve DC participation and performance,” says Bush.

Jason Vary, a vice-president at Actuarial Solutions Inc., emphasizes the need for a balanced legislative approach. “What we want is for more sponsors to adopt DC plans, instead of going in the direction of group RRSPs, which is where they’re heading now,” he says.

As Vary sees it, employers currently have no incentive to keep retirees’ money in their defined contribution plans. He suggests that safe-harbour provisions protecting plan sponsors from liability could have a big impact. Safe-harbour provisions currently exist for pension plans in the United States, which gives them an advantage over retirement savings plans.

“Safe harbours prevent pensioners from complaining about the investment planning tools sponsors use, so long as the sponsors act according to the rules and in good faith,” says Vary. “From an actuarial point of view, if employers have that protection, they shouldn’t have any complaints about legislation that lets the money stay in the DC plan at retirement, because that’s a good thing for everyone.”

Walking a fine line

Still, many stakeholders worry that increased regulations and oversight for defined contribution plans will drive employers to solutions with fewer rules.

“The difficulty is that Joe’s Garage isn’t really as engaged in providing pension plans as one might hope,” says Sanderson. “So if the owner is inclined to do something for employees, he’s more likely to look at [pooled registered pension plans], cash,

group tax-free savings accounts or profit sharing, all of which are relatively light in terms of compliance when compared to pension plans.”

While the concerns focus on government interference in small business, larger organizations with interprovincial or national scope may gravitate to the alternatives, particularly pooled plans. “A PRPP, for example, operates in a way that is essentially harmonized across the country, whereas the rules governing pension plans generally are not,” says Sanderson. “And to the extent PRPPs are not harmonized, these businesses don’t have to worry because financial institutions, who are intensely regulated, are the functional administrators of the plans.”

As Sanderson sees it, harmonization of pension legislation is critical.

“Harmonization is good for the consumer, because it accommodates their mobility and they have a better chance of understanding what’s going on. It’s better for employers, because they have to deal with only one set of rules, and it’s better for regulators, because they don’t constantly have to explain the differences to people who have gone off the regulatory rails,” he says.

To legislate or to guide?

The fact that governance, disclosure and enforcement issues are also in play has ramped up concerns that government interference will dissuade employers from offering defined contribution plans.

On the governance front, Alberta and British Columbia are leading the way. New legislation, expected to come into force at the end of this year, will require all plan sponsors to have a governance policy. While there’s no requirement to formally file the policies, they must be available to regulators on demand.

The impact on employers has varied.

“For the most part, sponsors have been on the governance train for some time, so the legislation is not revolutionary,” says Sean Maxwell, a pension lawyer at Blakes in Calgary. “Most sponsors are satisfied that they meet the regulatory requirements.”

To date, however, the requirements have hardly been onerous, consisting mostly of a handful of interpretative guidelines.

“The expectation is that the regulators would have provided more substantive guidance about the content of the governance policies; but at this point, they have for the most part deferred to the [Canadian Association of Pension Supervisory Authorities],” says Maxwell. “This means that the legislation hasn’t created a lot of work for sponsors who have developed their policies around existing CAPSA guidelines.”

The difficulty, however, is that many small plan sponsors have treated the impending legislation as something of an afterthought. “They don’t have highly developed processes in place,” says Maxwell.

Still, regulators are eschewing a punitive approach. “The idea isn’t to punish those who aren’t in compliance but to use the legislation as a gravitational pull to beef up governance,” says Maxwell.

Fremont, for one, favours guidance from CAPSA over legislative actions. “There’s a lot of moral suasion in the DC space where there are a limited number of service providers and the industry depends on their being compliant,” he says.

But by all accounts, it will take a while to fatten up the guidelines around defined contribution plans. “CAPSA is reviewing its defined contribution pension plans guideline,” says Leah Fichter, chair of CAPSA’s defined contribution pension plans committee. “Mainly, it is considering enhancing the guideline with respect to retirement projections and tools and member disclosure regarding fees and variable benefits. CAPSA has struck an industry working group to provide input into the revisions. The work with the industry working group is expected to continue into the fall, with recommendations to be considered by CAPSA towards the end of the year.”

For its part, the Ontario government has committed to ensuring that members of defined contribution plans get the information necessary to make informed decisions around their retirement planning. “The government will engage DC plan sponsors, the financial services industry and pension experts on potential changes to the annual statements that could help DC plan members prepare more effectively for retirement,” the budget stated. “The government will also explore other options to enhance transparency that would modernize member communications and create regulatory efficiencies.”

Arming the regulator

Looming over the debate about whether, and to what extent, legislative and regulatory action regarding defined contribution plans is necessary or desirable is the prospect of administrative monetary penalties. It’s an issue that’s particularly relevant in Ontario, which in early May released proposed amendments to pension regulations that would give the superintendent of financial services the authority to impose monetary penalties. “Ontario certainly seems to be moving to greater oversight of DC plans, although right now, it’s still pretty light,” says Fremont.

While the Financial Services Commission of Ontario has ramped up its examination of defined

contribution plans and their governance in particular, the investigations have had a narrow focus. “They don’t cover the breadth of issues with which DC plan administrators have to deal,” says Fremont.

FSCO has also been approaching oversight with a light touch, much as its counterparts in Alberta and British Columbia have been doing.

“The tendency has been to simply let administrators know what’s needed to comply,” says Fremont. “But once FSCO is armed with [monetary penalties], I expect them to take a strict approach that will force administrators to pay attention to areas in which their plans are lacking.”

The federal role

What’s clear is that the future of pension plan regulation is very much up in the air — so much so that some stakeholders say the current approaches are missing the mark.

“It doesn’t make sense to make improvements to DC plans in isolation from RRSPs and [deferred profit-sharing plans],” says Roman Kosarenko, director of pension investments at George Weston Ltd.

The primary difficulty facing plans, says Kosarenko, is at the federal level. “Current tax regulations don’t allow for the rollover of registered assets into longevity-pooling vehicles, other than annuities provided by licensed entities, which means that DC plans are unable to provide in-plan lifetime income in a non-guaranteed form,” he says.

“With that crippling regulation in place, DC plans will never be able to come close to DB plans. That’s a real pity, because non-guaranteed annuities can be adjusted on a prospective basis only, with no retroactive solvency deficits to allocate to plan members.”

Sanderson, meanwhile, emphasizes the need for a broader approach. “We do need to look at retirement income on a more holistic basis, with a view to integrating private savings, Canada Pension Plan, real estate holdings and non-registered investments,” he says. “It would be nice if we could get legislators and regulators to do that, but it probably won’t happen.”

Whatever emerges, Bush believes it will result largely from pragmatic happenstance.

“Is somebody really going to take the time to clean up pension legislation so it deals more clearly with DC plans?” she asks. “Probably not, and it’s much more likely that governments will just deal with these issues as they arise. But in my view, from the perspective of allocating resources, you can’t blame governments for doing it that way.”

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DC PLANS IN CANADA

DC plan membership:

2013

1,036,747

2014

1,097,211

Variance

5.8%

Public sector DC plan membership:

2013

143,034

2014

144,581

Variance

1.1%

Private sector DC plan membership:

2013

893,713

2014

952,630

Variance

6.6%

Source: Statistics Canada report on registered pension plan membership as of Jan. 1, 2015