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2017 Eckler CAP Legal Forum: Improving disclosure and decumulation

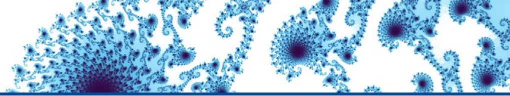
How can the government help modernize the Canadian capital accumulation plan (CAP) landscape? What regulatory changes are needed to help protect CAP sponsors from key risks relating to disclosure and decumulation?

Eckler's **2017 CAP Legal Forum** brought together some of Canada's leading pension lawyers and government representatives to discuss these issues. Key areas explored in this year's Forum include:

- the challenges of providing pension income projections;
- the need for better, more creative decumulation solutions; and
- the evolving record-keeper offering.

In its most recent budget, the Ontario government announced its intention to focus more on retirement income security and modernize the DC regulatory framework.

This was a signal that the government wants to take a more proactive role in the DC space, noted a representative from the Ontario Ministry of Finance who attended the CAP Legal Forum, particularly given the growing shift toward DC plans in Canada today. According to the representative, two areas where the government intends to play a greater role are DC disclosure and decumulation.



Developing DC disclosure

Requirements for information that should be disclosed to defined contribution (DC) plan members aren't as stringent as those for defined benefit (DB) plans and their members. Canada needs comparable disclosure requirements to improve outcomes for DC plan members, noted one lawyer. However, even the most detailed disclosure isn't helpful if plan members don't understand the impact of investment management fees, interest rates and other factors on their projected net income — which is often the case, said another.

One area where we might see future regulatory change is around retirement income projections. The Ontario government wants to investigate the merits of including such projections on plan members' annual pension statements, explained the government representative.

Providing income projections is helpful for plan members, agreed several of the Forum participants, and would further distinguish DC pension plans from registered retirement savings plans (RRSPs). However, it's a double-edged sword. Providing projections is risky if members perceive those projections as promises of future income. But not providing projections exposes plan sponsors to the risk of members not having enough information to understand the retirement income they're likely to get.

Simply relying on members to use income projection tools for insights and direction is problematic for three reasons. First, members must actually use these tools — and many don't (generally, only 15% of members access the online tools). Second, even if they do access the tools, research such as the *Benefits Canada CAP Member Survey* shows the assumptions members use (e.g., unrealistic expectations on investment returns) will lead them to incorrect conclusions about their ability to generate sufficient retirement income. Lastly, Eckler's recent research on income projection tools available in the Canadian market found these tools vary considerably in the depth of their calculations and the frequency with which their economic assumptions are updated. Many are extremely simplistic or dated and could produce very misleading results.

Further complicating matters, one of the lawyers also noted that, in a competitive marketplace, providers may prepopulate assumptions that lead to more favourable results — leading members to think they will do better with certain providers.

With the need for income projections well established, the challenge is to determine how to provide them to plan members in a meaningful way without creating false expectations. One suggestion to mitigate the risk is to show what the current income annuities can produce, based on different levels of accumulated savings rather than providing personalized projections.

Introducing "safe harbour" legislation in Canada would also help mitigate this risk, one lawyer noted. Such legislation already exists in the U.S. for sponsors of 401(k) plans, giving American plan sponsors potentially greater protection from legal liability than their Canadian counterparts. Canadian plan sponsors and the government could work together to find the right balance with such regulation, the lawyer suggested.

But there's a downside to safe harbour legislation, too. Being overly prescriptive can lead to a long list of exceptions and explanations and create a "buyer beware" system, noted one lawyer. It also provides members with a road map for litigation, added another.

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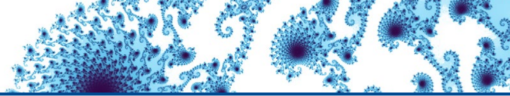

Finding better decumulation solutions

The government of Ontario is also interested in initiating a dialogue with the pension industry about decumulation and the barriers to DC plan sponsors offering such solutions to their members, said the government representative.

In particular, Ontario is interested in finding out what regulatory changes might help bring more decumulation products to market, and the appetite for innovation in this area. The current patchwork of pension regulations across Canada means decumulation options and opportunities can differ significantly, acting as an impediment to innovation.

Annuities can be a helpful tool to improve retirement outcomes, but they can be expensive and are poorly understood by members, noted the lawyers. One potential solution is to take the profit issue away by having the government set up an annuity branch and introduce a mandatory minimum annuitization level, suggested one participant. But the government representative said this course of action is unlikely.

The evolving record-keeper role

As market forces have pushed down the fees charged to administer CAPs, bundled record keepers are seeking new sources of revenue. This development coincides with a focus on financial wellness, which is broader than just retirement savings. In this context, record keepers are looking to offer members a broad spectrum of insurance products (travel, home, health, life, auto), mortgages, securities accounts, bank accounts, etc. — whether by offering advice or through direct marketing. While the lawyers agreed it's not appropriate for providers to be pushing products, the true risk to the plan sponsor arises only if there are damages, they noted.

To evaluate and mitigate any risks, plan sponsors first need to have a strong understanding of the services and communications their members are being offered. Meeting with the record keeper to understand the different services available and where each falls on the advice spectrum (from information, education, illustrations and in-plan advice, to full financial planning) is the first step. Plan sponsors have the right to determine how they want their record keeper to interact with their members.

If a plan sponsor decides to offer advice or allow the provider to advertise other financial products, it's wise to take additional steps. The lawyers agreed that, while plan sponsors should be clear with members that they're not endorsing the products on offer (or the advice provided), they are still the medium for introducing the services to the member and delegating that role to the record keeper. The lawyers noted that when you delegate a role, you are responsible for conducting due diligence and overseeing that delegate (e.g., in terms of qualifications, compensation, etc.). One added that while some providers offer indemnity to the sponsor against claims, sponsors should carefully review these agreements to ensure they have proper protections. Should a court find the documents aren't strong enough, the plan sponsor is still the fiduciary — and will be held accountable.

Time for a change?

The *Pension Benefits Standards Act (PBSA)* was introduced in 1985, and it was originally designed for a DB environment, noted the Forum participants. Over the years, there have been legislative "add-ons" across the country but few, if any, directly address DC plans, the participants added. There are also differing legislative trends based on jurisdiction.

A good example is the role of the Statement of Investment Policies and Procedures (SIP&P) in DC plan governance. The most recent federal changes have eliminated the need for a DC plan sponsor to even have a SIP&P. By contrast, recent amendments to Ontario's pension regulations require not only that DC plans maintain a SIP&P, but also that the SIP&P must be filed with FSCO. The amendments also require the SIP&P to indicate whether the plan considers environmental, social and governance (ESG) factors in its investment process. Plan sponsors, one lawyer noted, find it hard to understand the new ESG rule and how it is even applied in a DC environment.

What's really needed is an overhaul of the PBSA — or perhaps even a separate DC act — the lawyers agreed. From a payroll tax perspective, it's cheaper to offer a DC plan than an RRSP, so making DC plans easier to implement could cause more plan sponsors to switch back from RRSPs. The government representative agreed a legislative change along those lines is overdue and would help DC plans compete with other solutions, enhancing Canadians' financial security in retirement.

Part of the challenge to making changes is a lack of impetus. The pension industry has been talking about impending DC class action lawsuits for years, but Canada hasn't seen any significant lawsuits so far. One reason is that the first major wave of DC members hasn't retired yet — but that's about to happen, and efficacy of the DC system will soon be proven, one lawyer noted. If we do see lawsuits, they will likely be against the insurance companies, because they're holding most of the DC assets and providing most of the tools — and they have the deepest pockets, another lawyer speculated.

With the current lack of clarity regarding administration and oversight of DC plans, if a group of members are unhappy with their outcomes, there are valid arguments against most of the decisions made by plan sponsors. In this grey environment, plan sponsors need to protect themselves by demonstrating they've established processes and are following them.

With or without significant DC litigation, plan sponsors still need to be careful how they position DC plans to plan members and manage their expectations, one lawyer cautioned — particularly since the average member often has trouble understanding saving and investing concepts such as income replacement, interest rates and the impact of investment fees.

The next iteration of DC

As the DC space grows, it's becoming more apparent that there are regulatory gaps preventing plan members from achieving the best outcomes. But, the Forum participants noted, the big question remains: does more regulation simplify the task of running a DC plan or make it more onerous?

While the Ontario government has hinted about the direction it might take with DC regulations, the details remain unclear. But it's a perfect time for pension reform — not just in Ontario but across the country — since the provinces and the federal government have all shown significant interest in the pension space recently, one participant explained. And Canada's public discourse about pensions is positive: there's greater appreciation of pensions than ever. The challenge to the pension industry is to take advantage of that goodwill without overplaying its hand.

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