Seeing Beyond Risk Canadian Institute of Actuaries Institut canadien des actuaires Voir au-delà du risque

# Submission by the Canadian Institute of Actuaries to the House of Commons Standing Committee on Finance

**August 2011**

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### Who we are and what we do

The Canadian Institute of Actuaries (CIA) is the national organization of the actuarial profession.

The CIA establishes the Rules of Professional Conduct, Guiding Principles and monitoring and discipline processes for qualified actuaries. The CIA follows its Guiding Principles, including Principle 1, which holds the duty of the profession to the public above the needs of the profession and its members. The CIA also assists the Actuarial Standards Board in developing Standards of Practice applicable to actuaries working in Canada. All CIA members must adhere to the profession's Standards of Practice.

Actuaries apply their specialized knowledge in the mathematics of finance, statistics and risk theory to problems faced by pension plans, social insurance programs, government regulators, financial institutions and individuals. We believe these skills also make actuaries uniquely qualified to greatly contribute in the emerging field of enterprise risk management.

The CIA welcomes the opportunity to share our thoughts on issues that may have an influence on your budget deliberations.

### Themes

The two items we are putting before you this year are 1) comments on the implementation of Pooled Registered Pension Plans (PRPPs) and 2) the value that actuarial science can bring to the health care system and to the coming negotiations for a new Health Accord.

Over the past five years, we have presented a number of ideas to this committee and other groups across the country, primarily in the pension arena, specifically on pension reform. A few of them have been acted upon, namely increasing the maximum allowable surplus in a pension plan before employer contributions must stop and permanently permitting the use of Letters of Credit to guarantee solvency deficiency amortization payments. Even though these two elements will contribute to increasing pension benefit security for Canadians, we believe that the adoption of a third one would have an even more significant impact, namely, the introduction of legislation that allows employers to set up 100% employer funded pension security trusts[i] that would be separate from, but complementary to, the regular defined benefit pension funds.

In the past nine months, the retirement savings focus of federal, provincial and territorial finance ministers has been on PPRP. The Institute believes that PPRPs are interesting options for Canadians saving for retirement; however, we believe they must be implemented in a way that makes them attractive to employers, employees and plan administrators. Proposal 1 below contains the thinking of the profession on their implementation.

In Proposal 2, we share our thinking on the value that actuarial science can bring to the health care system and the upcoming renewal of the Health Accord.

### Proposals

1. **Pooled Registered Pension Plans (PRPPs)**

Canadians should be saving more for retirement. For the past several years, this fact has put pension and retirement saving issues on the national agenda. A great deal of attention has been focused on fine tuning the current system and implementing new ideas including modest to revolutionary increases in Canada Pension Plan (CPP) benefits. As the provincial and federal

Finance Ministers met last December, it became apparent that the focus had shifted to PRPPs.

While Canada's actuaries are on record as stating that this type of plan, in and of itself, is not sufficient to resolve the country's retirement income issues, it does hold some promise, if it is part of a comprehensive solution geared to tackling the ever-growing pension problem, and is implemented properly. We see PRPPs as just another option for retirement savings.

The following represents the thinking of the profession on PRPPs that we presented to the Department of Finance and the provincial officials involved in developing a framework for PRPPs:

We support the development of another option for Canadians' retirement savings **if** it results in efficiencies, lower costs and better access to savings plans, especially for the self-employed and employees of smaller employers.

Our primary recommendation in this area is that **PRPPs should be subject to simple, efficient and harmonized rules across Canada. In order to achieve this, an option would be to regulate PRPPs** as a form of tax-registered retirement savings vehicle rather than through the patchwork of federal and provincial pension legislation. We believe this could be accomplished by adding a separate section to the Income Tax Act similar to those already existing for registered retirement savings plans (RRSPs) and deferred profit-sharing plans (DPSPs). Such an amendment could include locking-in requirements and should provide payroll tax relief on PRPP contributions.

We have concerns about the challenges faced by PRPPs:

- It will be difficult to rapidly accumulate sufficient assets to benefit from cost-reducing economies of scale unless existing savings arrangements are transferred to the PRPP (such transfers would be more attractive if the PRPP is a simple product and responsibilities are transferred to the PRPP's administrator).
- We are concerned PRPPs will be registered pension plans subject to complex federal and provincial pension legislation that has a track record of unnecessary variations. Simplicity will be a key factor in this new option's success.
- We are concerned about the viability of a single PRPP vehicle that will comply with complex provincial and federal rules at the same time, knowing the mosaic of existing rules. For example, locking-in/unlocking rules that vary according to the member's jurisdiction of employment would add material cost to the administration of PRPPs. In addition to locking-in, re-enrolment rules are another clear example of where jurisdictional variation in rules should be avoided.
- We do not support a mandatory requirement for employers to offer the PRPP to employees even if there are no mandatory employer contributions. This would result in unnecessary costs for certain employers, considering that many employees do not need to save more for retirement and the PRPP's cost may not be lower than some registered plans already available.
- We support a legislative PRPP framework where the employer's responsibilities would be significantly reduced or eliminated, and transferred to the administrator of the PRPP, provided participants' best interests are protected. If governments want PRPPs to be offered at reasonable prices, the element of competitiveness needs to be present. For example, a minimum number of providers need to be interested in the business and there should be simple, well-defined obligations for the PRPP provider.

- We support having a PRPP licensing regime if the rules are harmonized across Canada.

## 2. Actuaries—independent and objective thinking applied to health care

Actuaries are professionals who evaluate the financial implications of uncertain future events, and are experts in long-term cost projections. Of all recognized professionals, actuaries are the only ones specifically trained to advise on the financial status of insurance programs and to assess the impact of benefit plan changes, demographic changes and the impact of new medical technologies, for example.

The Office of the Chief Actuary currently applies actuarial science to the Canada Pension Plan, Old Age Security, the Canada Student Loans Program and the pension plans for Members of Parliament, Canadian Forces, the Public Service of Canada and the Royal Canadian Mounted Police. Actuaries are involved in other social insurance programs, such as Employment Insurance and Workers' Compensation.

Actuarial capabilities and input are currently used in the private life, health and property/casualty insurance sectors. To say that the work they perform touches the lives of virtually every Canadian is an understatement.

The Canadian Institute of Actuaries believes that as:

- Medicare is a cornerstone of Canada's social and economic safety net;
- the health care system is under constant funding pressures;
- the impact of new technologies on the cost and provision of quality health care services that Canadians have come to expect, needs to be assessed; and
- the demographics of the population edge into an era of unprecedented change resulting in exceptional challenges to the funding and sustainability of the current system,

the skills, expertise and abilities of actuaries need to be brought to bear on the trials confronting Medicare.

**We call on the government to take advantage of the application of actuarial science to financial issues and cost projections regarding the adequacy and efficiency of Medicare funding and its alignment with future needs.**

Actuaries would provide objective analysis and expert advice to governments on questions related to health care design, benefit coverage and funding in order to:

1. Create opportunities to engage Canadians in open discussions about alternative strategies for the future of the public health care programs and their associated costs;
2. Help develop insights that should lead to the development of proper incentives and innovative solutions so that public health care programs become more efficient and sustainable, in the long run;
3. Help capitalize on future demographic and technological trends to direct strategic resources needed in the short, medium and long-term;
4. Help balance the demographic pressure on health care funding between the provinces to the federal government; and
5. Develop appropriate modeling and datasets to establish what services are most efficient under tighter health care budgets.

As mentioned above, actuarial science and its practitioners are already trusted advisors in pensions, insurance and the country's vast social programs. We believe that, in the public interest, it is time to put this expertise to work on the problems facing the health care system, and the Canadian Institute of Actuaries is committed to pursuing this initiative with the government and assisting in moving the process forward.

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[i] **Pension Security Trust – an innovative approach to pension funding**

A new type of funding vehicle is needed, with clear ownership of assets, to supplement the existing registered pension plan trust.

We believe that most plan sponsors would be willing to fund a Defined Benefit plan more securely, thereby improving benefit security for the members, if they knew that they could access any surpluses that might arise from their excess contributions. This confidence would encourage plan sponsors to continue their Defined Benefit plans or to start new Defined Benefit plans.

We propose a Pension Security Trust as an innovative way to facilitate this improvement. Plan sponsors would be able to contribute to the Pension Security Trust, which would be complementary to the regular Defined Benefit pension funds. The assets would be invested in a manner similar to the regular pension plan, and would be held as a side fund by the trustee and custodian. Unlike the registered pension plan trust, however, the Pension Security Trust would include plan sponsor contributions only and would be "owned" by the plan sponsor.

Solvency deficiency payments and additional payments that the plan sponsor may choose to make to strengthen the funding of the plan would be placed in the Pension Security Trust. Contributions arising from going concern valuations would go into the regular pension fund. If subsequent valuations showed that some of the assets in the Pension Security Trust are not required to pay plan benefits, then the excess could be released back to the plan sponsor. All money contributed to the Pension Security Trust would be tax deductible, while amounts withdrawn would be taxable.

The establishment of a Pension Security Trust would not require an increase to the current tax limits on contributions to pension plans. The plan sponsor's contributions to the Pension Security Trust would be considered, together with the contributions to the pension fund, when applying the current Income Tax Act limits on plan sponsor contributions each year.

We recommend the establishment of a tax-deductible Pension Security Trust under the Income Tax Act and Regulations in order to facilitate these pension contributions, resulting in higher levels of funding and enhanced benefit security for the members of Defined Benefit pension plans.

*Submission by the Canadian Institute of Actuaries to the House of Commons Standing Committee on Finance, August 2007, Document 207076*