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**Delivered via E-mail**

**RE: Proposed Guidelines for Capital Accumulation Plans**

Dear Mr. Hall:

On behalf of Standard Life, I am pleased to submit our response to the invitation to comment on the proposed guidelines for CAPs released April 25th.

Standard Life is a major service provider to the CAP market in Canada. Our clients are found across Canada, in every jurisdiction. Our services encompass the design, documentation, compliance and maintenance of CAPs as well as the education of, and communication to, CAP members and the investment of CAP assets in a variety of funding instruments. We manage approximately \$6 Billion of retirement assets on behalf of over 400,000 CAP members and are very familiar with the practical impact of the proposed guidelines.

Standard Life applauds the efforts of the Joint Forum to bring harmony, clarity and transparency to the regulation of CAPs. In particular, we welcome any progress on simplifying the confusing – and sometimes conflicting – rules that try to govern the investment of CAP assets. Standard Life is not alone in this view. It is with much pleasurable anticipation that many CAP sponsors, members and service providers look forward to the results of the Joint Forum’s work. The goal of the Joint Forum is widely-endorsed: “to coordinate and harmonize the treatment of CAPs...”

It must be noted that the authority of the guidelines proposed by the Joint Forum does not derive from legislation - unless and until the competent law-making and rule-making bodies enact new regulations. In the interim, the guidelines will have whatever weight the community of sponsors, members, advisors and service providers give them. This, in turn, will depend on how well-attuned the proposals are to the reality of the industry: its goals, its needs and its practices.

In this regard, the guidelines must meet high standards of clarity in their wording and practicality in their application. As the process of consultation continues, we have the opportunity to elaborate and refine the proposals to meet the criteria of clarity and practicality. In some cases, the current proposals can create what we believe are unintended negative consequences. Fortunately, with the support of all industry players, these concerns can be addressed quickly and easily. We propose possible wording to remove any unintended impact on the health and vitality of CAPs.

This submission that follows will focus on a few issues of clarity and practicality.

We very much support this consultation process. It is through the industry and regulators working together that we will develop the mutual understanding which is the foundation of effective regulation. We applaud the efforts undertaken to this point and look forward to continuing to work together.

Yours truly,

Claude Garcia

President, Canadian Operations

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## **Introduction**

This submission will focus on a few issues of clarity and practicality, attempting to answer the following questions:

1. Why do CAPs exist?
2. What is the problem with the regulation of CAPs?
3. What is wrong with Section 2.2.2?
4. How has the industry addressed the investment issue?
5. Why is this issue so easy to miss?
6. What are the consequences of the different interpretations?
7. How can we move forward?
8. What options do we have to fix Section 2.2.2?
9. What is wrong with Section 5.1.3?
10. What are the potential consequences of Section 5.1.3?
11. How can Section 5.1.3 be fixed?
12. Are the Guidelines as clear as they need to be?

Standard Life appreciates the opportunity to participate in this important consultation and we would be happy to expand on our comments as necessary.

### **1. Why do CAPs exist?**

The goal of every CAP sponsor is to provide a benefit to the CAP's members – a benefit the sponsor hopes will be appreciated by the membership and will contribute to the sponsoring organization's success. It is also worth noting what the goal is *not*. The goal of a CAP is not to treat members as consumers and try to generate profits from the sale of products to them.

### **2. What is the Problem with the regulation of CAPs?**

The issue does not seem to be driven by consumer complaints or bad experience with existing CAPs. The heart of the problem lies in the fact that official rules were never written with CAPs in mind. The result is that there are no investment vehicles specifically designed to comply with the generic CAP rules – since such rules do not exist. Currently, the regulation of CAPs is neither harmonized across Canadian jurisdictions, nor across the insurance, pension and securities sectors within each jurisdiction. CAP sponsors and service providers have done their best to discern the spirit of the rules and apply them, however, the existence of confusing, overlapping and sometimes conflicting regulations is, to say the least, not an encouraging feature of the CAP environment.

Furthermore, it appears that the Joint Forum is not proposing to create any rules which would *replace* the existing patchwork, but simply add some guidelines on top. A good example of this is found in Section 2.2.2 of the proposed guidelines.

### **3. What is wrong with Section 2.2.2?**

Section 2.2.2 addresses investment funds offered in a CAP. In its final paragraphs, it highlights the existence of three different sets of regulations that may apply to investment funds used in CAPs, as follows.

“Investment funds offered in a capital accumulation plan must comply with:

- the investment rules applicable to Individual Variable Insurance Contracts if the investment fund is an insurance product; or
- the investment rules under National Instrument 81-102 Mutual Funds if the investment fund is a mutual fund under securities law.

If investment funds are offered in a CAP that is a registered pension plan, the funds must comply with the investment rules under applicable pension benefits standards legislation.”

For any guidelines to be effective, they must be clear. The underlying intent of proposed Section 2.2.2 is not obvious. Is the goal

- to uphold the *status quo* (three sets of regulations addressing the same issues), or is it
- to propose higher standards (applying rules where they do not apply today), or is it
- to propose that complying with any *one* of the IVIC rules *or* the mutual fund rules *or* the pension rules would be sufficient to satisfy the regulators?

Having exposed the draft to different audiences, we conclude that different readers will have widely differing interpretations. They will not all agree on the Joint Forum intentions in this area.

### **4. How has the industry addressed the investment issue?**

In keeping with the goal of CAPs, sponsors and service providers always seek solutions which will maintain or improve the satisfaction of CAP members. In the 1990’s investment conditions were changing and members began demanding more choices than the traditional GIC or the typical family of funds from one investment manager. In particular, members wanted to see a variety of fund options, including recognizable brand name mutual funds.

Sponsors and service providers responded by creating convenient and cost-effective arrangements that incorporated the diverse options desired. At that time, as today, the

regulatory framework was not favourable to such innovations. Nonetheless, the innovative packaging of group seg funds, mutual funds and institutional pooled funds into balanced portfolios respected the fundamental regulatory goals of diversification, liquidity and disclosure.

The success of this approach can be seen by the extent that CAP sponsors and members embraced the “new and improved” CAP pioneered by leading sponsors and service providers. Today, literally billions of dollars are invested by millions of Canadians in CAPs that conveniently offer CAP members a diversified selection of investment options. Members can build balanced portfolios by choosing among pooled, segregated and mutual funds in a single package. Sponsors operate their plans in a straightforward and practical manner without complaints about investment concentration or liquidity – and without concern for the arcane complexities of the competing regulatory regimes.

The secret of the success is that the industry has recognized the underlying commonality of the insurance, securities and pension regulations and upheld the goals of appropriate diversification and liquidity.

## **5. Why is this issue so easy to miss?**

The regulation of investment funds is not the most simple aspect of the financial services industry. It is easy to draw wrong conclusions or misinterpret the application of the various rules. Indeed, it is not easy to draft wording which can guide readers through such a complex area. In order to appreciate the implications of the proposed wording in Section 2.2.2, it helps if the reader possesses an intimate knowledge of the three regulatory systems that could, depending on the circumstances, apply to the investment funds of a given CAP.

In fact, it is very easy for the essential problem of proposed Section 2.2.2 to be overlooked. Most who will read the consultation draft are aware of the general thrust of the investment provisions of the respective regulations: ensuring appropriate diversification and liquidity. To recognize its full implications, however, the reader must be conversant with the details of each set of regulations and how they are – or are not - applied.

Of course, there are experts in Canada – within the regulatory community and within industry – who specialize in the investment provisions applicable to Individual Variable Insurance Contracts (IVICs). There are experts in Canada who specialize in the investment provisions of securities legislation applicable to mutual funds. There are experts who specialize in Canadian pension legislation and what it has to say about investments.

Equally, there are experts who specialize in the group counterparts of IVICs and mutual funds: the institutional pooled funds, group segregated funds and private placement mutual funds.

Unfortunately, there are few people who possess expertise in all of these areas.

## **6. What are the consequences of the different interpretations?**

We do not know which of these three interpretation (if any) is correct, so let's take each of them in turn, starting with maintaining the nominal *status quo*.

### First Interpretation :Upholding the Nominal Status Quo

If the goal of the Joint Forum's draft is simply to remind readers that there are three regulatory regimes that could apply to the investment funds in their CAP, then we have described the problem – not any solution to it. We will have failed to meet the expectation that there is a way forward that offers harmony and clarity.

We will have given no comfort to those who have tried to assist their CAP members to diversify their holdings into the widest possible variety of types of funds despite regulations which are, at the very least, confusing in their application. Why is the *status quo* a problem?

As has been noted elsewhere, there are three sets of regulations that may apply to investments in a CAP. While the goals of the regulations may be common, each set has its own unique approach to achieving these goals. This reality makes it exceedingly difficult and prohibitively expensive for a single fund in a CAP to be managed in such a way that it simultaneously satisfies the different rules. This is not surprising since the rules we have were not drafted to apply to all CAPs.

The most obvious challenge is meeting the requirements of the diversification rules. The problem is not at the high level – all of the rules aim for the same result. The problem is in the details of the application. One set uses book value, another market value. One set measures concentration at the time of the transaction, another continuously. One set looks at the whole plan, another examines individual funds.

A closely-related issue to the problem of overlaps is the issue of gaps in regulations. What rules apply to the investment options of a Group RRSP funded by institutional pooled funds?

The ultimate consequence of entrenching the *status quo* will be continued confusion and uncertainty. Please see below for a description of the practical solutions the industry has brought forward to address this technical problem.

### Second Interpretation: Increasing Regulation

The second possible interpretation is that the Joint Forum means to extend the current rules to apply where they have not been applied in the past.

The retirement industry in Canada encompasses both defined benefit and defined contribution pension plans. Many investment management firms have been created to cater to the needs of pension plan investors. Historically, the defined benefit portion of the market has been the larger segment and many investment funds have been designed without reference to the IVIC guidelines or mutual fund rules, but specifically to comply with pension standards. As defined contribution pension plans increased in popularity, many of these funds were made available to defined contribution pension plans. In addition, these same funds were offered under Group RRSPs and other CAPs.

These funds are not offered directly to the retail public. They are referred to as “institutional pooled funds” or “private placement mutual funds”. The second interpretation of draft Section 2.2.2 suggests that they would have to comply with the rules applicable to mutual funds, once again raising the administrative nightmare of having to simultaneously satisfy competing sets of regulations.

Similarly, insurers have created group segregated funds to meet the needs of pension plans – and other CAPs. These funds follow pension standards and are not offered to the retail public, however, the draft wording suggests that they must comply with the IVIC guidelines drafted for retail products. A glaring example of the impossibility of meeting the layers of regulation would be offering access to employer stock through the mechanism of a segregated fund. Diversification goals can be met at the level of the plan (or account) but certainly not at the level of a fund which mainly invests in a single security. Again, we have the unworkable situation of trying to comply with differing regulations at the same time.

Finally, the potential exists for some funds offered in CAPs to be simultaneously subject to all three sets of rules! In their capacity as the primary record-keepers to the CAP marketplace (where the investment and benefit records are closely linked), insurers have created funds on funds and funds *of* funds. Canada’s insurers have wrapped retail mutual funds inside segregated funds and created funds which combine the units of a number of component funds. A consistent interpretation of draft Section 2.2.2 would require that such funds, used in a pension plan, satisfy the IVIC guidelines and the pension standards while the underlying mutual fund or funds would meet the mutual fund requirements.

It should not be necessary to elaborate on how such a development would not be welcome news to CAP sponsors and service providers. What is the benefit of increasing the costs of compliance? What problem is being solved?

### Third Interpretation: Upholding Commonality and Harmony

The third possible interpretation is more hopeful. Since all three sets of rules recognize the same key goals, it makes sense to uphold that commonality and accept that ***compliance with any one of the three is substantially the same***. The consequence would be a liberating triumph of common sense over legalism. Plan sponsors would be able to maintain their CAPs with confidence.

## **7. How can we move forward?**

At this time, we merely ask that the regulators recognize the acceptability of the good-faith solutions put in place to serve the needs of CAP members.

More precisely, we ask the Joint Forum to formally agree with the conclusion of the 1999 study of the CCIR and CSA comparing the treatment of IVICs and mutual funds. That in-depth study stated that “there exist many similarities in the regulation of the products – in essence the goals of both regulation are similar”. In view of this reality and the reality that a practical solution is already in place, we ask the Joint Forum to endorse the third interpretation and adopt the position that the investment provisions of all three regulatory regimes are sufficiently similar that, in the context of a CAP, compliance with any one of them is sufficient.

## **8. What options do we have to fix Section 2.2.2?**

The Joint Forum has a number of possible ways to correct any misinterpretations of the current draft text. One solution is to simply remove the specific part of the section that gives rise to the problem; another is to re-word it slightly; and another option is to completely rewrite it. Each has its own pros and cons.

### Option One: Removing Part of Section 2.2.2

Dropping this section addressing IVIC, mutual fund rules and pension legislation is the easiest approach. It would remove the possibility of misinterpreting the intent, but would not actively promote a new understanding of clarity and harmony.

### Option Two: Slight Re-wording of Part of Section 2.2.2

A slight re-wording can clarify the Joint Forum’s intentions, rendering the text as follows:

“Investment funds offered in a capital accumulation plan must comply with one of the following:

- the investment rules applicable to Individual Variable Insurance Contracts; or
- the investment rules under National Instrument 81-102 Mutual Funds; or
- the investment rules under pension benefits standards legislation.”

This re-wording makes it clear that the Joint Forum accepts the commonality of the standards in each set of regulations, despite their technical differences.



### Option Three: Further Re-wording of Part of Section 2.2.2

An even more proactive approach would be to expand the list of acceptable standards to include any other equivalent investment rules found in domestic or international regulations. This would allow the Guidelines to accommodate any future legislation aimed specifically at CAPs as well as any existing rules which currently apply to, say, US-based funds available in Canada.

Such a further re-wording would affirm the principle that prudent conduct does not depend on adhering to a set of rules that were never intended to cover CAPs. Lifting the burden of trying to comply with rules written for other circumstances (e.g., retail products, defined benefit pension plans), would be seen positively by CAP members, sponsors and service providers.

Suggested wording:

“Investment funds offered in a capital accumulation plan must comply with one of the following:

- the investment rules applicable to Individual Variable Insurance Contracts; or
- the investment rules under National Instrument 81-102 Mutual Funds; or
- the investment rules under pension benefits standards legislation; or
- the investment rules under any other equivalent domestic or international regulations.”

### **9. What is wrong with Section 5.1.3?**

Section 5.1.3 addresses the content of statements a CAP sponsor must provide. Transparency is a key theme of the CAP guidelines. A CAP member should always be able to obtain information which is pertinent to their account and needed in the management of that account. Accordingly, Standard Life fully supports the effort to ensure every member has access to information. This support, however, does not necessarily extend to directives which would serve to drive up costs while providing little or no benefit. For the guidelines to have real value, each one must be practical and cost-effective to implement.

We believe that Section 5.1.3 contains an example of a guideline which is both impractical and of little benefit.

- Transaction details – investment description: date of transaction, transaction type (eg. Interfund transfer), amount, unit value (if applicable), units purchased or withdrawn;”

In just these few words, the fifth bullet point of Section 5.1.3 proposes to require a sponsor to report to each member the details of every transaction occurring throughout the year. At first glance this does not sound like it would be an issue, however, an

examination of the volumes of fund level transactions common to modern CAPs will reveal the consequences of Section 5.1.3.

Most CAPs feature payroll deduction of contributions. Payroll frequency is typically every two weeks. Many CAPs require both employee and employer contributions to be invested on behalf of the member. Some CAPs allow for supplementary or additional voluntary contributions from the member. Record-keepers often set up separate accounts for each type of contribution, so members can manage each account independently from the others. Finally, as the Joint Forum knows very well, multiple investment options are offered to members so they can build their own balanced portfolios to meet their personal needs and preferences.

All of these factors multiply the number of transaction details kept in the record-keeping system. Having 26 pay dates, with three sources of contributions each invested in five funds results in 390 (26X3X5) lines of transaction details. Dumping out all of this data can create unwieldy reports. For this reason, service providers offer summaries, transaction confirmations, inquiry services and information on demand.

An example of an extract from a member statement which complies with the requirement for transaction details is attached. It runs to many, many pages and it is difficult to imagine that a CAP member who receives it would read every page. Nonetheless, in order to comply with the proposed guideline, the CAP sponsor would be required to have this type of statement produced and distributed for every member of the CAP.

## **10. What are the potential consequences of Section 5.1.3?**

If such a statement is to be printed and mailed, it will result in higher printing and postage costs (to be passed on ultimately to the CAP members). If such a statement is to be electronically distributed, the CAP member would end up using his or her own precious ink and paper to render a hard copy – or scroll through 15 or more pages of numbers on a computer screen!

Aside from raising costs, the impact of this seemingly-innocuous requirement may also be seen in the level of diversification offered to CAP members. The higher the costs of adding investment options, the greater the tendency will be for CAPs to be designed with fewer investment options and less flexibility for the CAP member to manage his or her account(s) to suit their personal circumstances. This would be an ironic consequence of measures aimed at supporting and equipping members to take charge of managing their CAP accounts.

## **11. How can Section 5.1.3 be fixed?**

The preferred alternative is to make this level of detail an option for those who desire to see it.

## **12. Are the Guidelines as clear as they need to be?**

The heart of any guidelines must be the highest standards of clarity. Sponsors, members and service providers must be confident they understand the intent of the regulations. This confidence is founded on clarity – and a mutual understanding of the goals, needs, and practical reality of the CAP world.

It would seem evident by the questions raised in this submission that the current draft is subject multiple interpretations. If readers of the guidelines do not share an understanding of their meaning, their intent and their practical application, the guidelines will have the opposite of the desired effect, creating more confusion and uncertainty. This is of particular concern in view of the fact that the guidelines, once finalized, would have to stand on their own. There is no single, permanent, national regulator of CAPs to whom CAP sponsors, members and service providers can turn for authoritative interpretations of the wording of the guidelines. Unless the Joint Forum – or another authority – is prepared to take on such a role, the guidelines will have to speak for themselves, so the utmost in clarity is essential.

We strongly recommend that the Joint Forum Working Committee revisit and revise the entire text of the proposed guidelines to incorporate definitions of all terms and consistent usage of these terms. There should be no doubt as to the intent of the guidelines and the conclusions to be drawn from them. Standard Life will be pleased to continue its participation in the drafting and consultation process with the goal of ensuring a clear and positive result.

## **Conclusion**

The work of the Joint Forum to create harmony, clarity and transparency has raised expectations throughout the CAP industry. In some quarters, the draft guidelines have also raised fears. It is precisely because CAP members, sponsors and service providers look to the Joint Forum for leadership and guidance that we treat each word in the proposed guidelines with such seriousness.

Given the importance of CAPs to the financial security of Canadian workers, we look forward to the continuing work of the Joint Forum and are grateful for its willingness to engage all stakeholders in finding the best way forward.

**Extract from Sample Annual Statement to a CAP Member**  
to illustrate potential volume of required data

This extract shows the Summary of information for a typical member (pages 3 through 6) followed by the Transaction List (pages 7 through 21).



Sampletr.pdf