

129 Pinewood Trail
Mississauga, ON
L5G 2L2

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To: Davin Hall, Policy Manager (A)
CAPSA Secretariat
c/o Joint Forum Project Office
5160 Yonge Street
Box 85, 17th Floor
North York, ON
M2N 6L9

Comments on Proposed Guidelines for Capital Accumulation Plans

I welcome the opportunity to comment on proposed CAP guidelines from the point of view of a Member of one of these plans.

I write as a private investor with more than 20 years of investment experience in funds, individual equities and derivatives. Although not directly employed in the financial services industry, I have an MBA and finance is my hobby. Over the years I have completed several courses from the Canadian Securities Institute and this year I passed the Level III exam of the Chartered Financial Analyst program offered by AIMR.

My comments are divided into two parts:

1. Part I provides feedback around 4 recurring important themes:
 - a. Standardized disclosure on fees and costs and their impact on investment returns
 - b. Timeliness, quality, accuracy and completeness of Member Statements
 - c. Member participation in CAP governance, oversight and regulatory changes
 - d. Clear regulatory process to resolve Member complaints
2. Part II offers specific paragraph by paragraph amendments to the proposed guidelines that flow from the themes.

I welcome the opportunity to have provided my input and sincerely hope that the future will be better.

Respectfully submitted,

Tony Paine

Part I: Thematic Response to the Proposed Guidelines

My CAP Plan

I work for a large multi-national firm with a significant presence in Canada and status as one of the “Best 50 companies to work for”. For reasons of personal employment security, I shall call my employer YYYY Canada. My employer offers a CAP managed by a major Canadian life insurer that I shall call LifeCo. If we contribute up to 3% of our salary to this CAP, then YYYY Canada will match it with a sliding scale amount that is approximately 2% of our salary. The plan has been in effect for a decade or so, so is now valued at about 50-100% of the salary of longer-term contributing employees and has become a significant financial asset for many that provides significant amounts of fees to LifeCo.

We are required to use LifeCo as the Service Provider in order to get the company matching contribution. This makes us economically captive to LifeCo and unable to switch providers unless we withdraw from the plan and lose two years of company contributions before we can join again.

LifeCo offers a semi-broad traditional array of investment products, including GICs and Seg Funds totaling 80 or so, with Investment Management Fees (IMFs) of 50-250 bp. However, some market segments such as emerging markets, income trusts, mortgages, ETFs, etc. are either not available or available only with fairly high fees. Although mutual funds might suit small monthly contributions, lower cost but unavailable ETFs could well be the preferred long-term vehicle once assets in a fund exceed about \$3,000.

Employees make the majority of the CAP contributions, yet had no input that I know of in the design of the CAP, the selection of LifeCo, the investment products on offer, or the monitoring of LifeCo performance.

Specific Issues that Relate to the Proposed Guidelines

LifeCo has demonstrated some questionable business practices over the past few years that have been vigorously defended by senior management of LifeCo, their Ombudsman, and YYYY Canada senior managers. LifeCo claims these practices conform to all existing and proposed regulations for the industry – including the CAPSA proposals.

The objectionable business practices include:

1. Strong emphasis on Gross Return performance presentation

2. Partial fee disclosure – IMF not MER
3. False Member Statements
4. Disappearing Units

Gross Return performance presentations. The majority of the performance information about investment funds that we get from LifeCo is in terms of Gross Returns, especially in any and all marketing materials comparable to a prospectus, which comes with a complete absence of corresponding Net Returns for the same periods, and often lacks an IMF list. What little net return information we receive comes only in Member Statements and relates only to periods ending as of the statement date.

Partial fee disclosure. Instead of the all-in MER from a mutual fund, LifeCo occasionally gives us a list of Investment Management Fees (IMFs) that include only some of the costs. The IMF must understate the MER quite substantially because the Gross minus Net Return is 30-60 basis points higher than the IMF.

LifeCo claims it cannot easily calculate individual MERs because there are so many different IMF schedules for different clients. Nevertheless, LifeCo does manage to calculate a few Net Returns for the Member Statements. The impression is that LifeCo does not want its fee schedule to be directly comparable to mutual funds because the discrepancy between IMF and MER, in combination with Gross Return performance presentations, suits its marketing objectives.

False Member Statements. When a reporting period ends on a weekend, LifeCo deliberately reports the value at the end of the first trading day of the next month as the value at the end of the reporting period (e.g. Oct 1 values reported as Sep 30 values – for the Member assets and for the net fund return information). Since this is the only source of net fund information, Members trying to compute net returns over consecutive periods get inconsistent results.

Disappearing Units. When LifeCo reduced the management fees on a fund, it caused a variable number of units to disappear from every affected Member Account – with no record to the member. As a result, Member Statements from one period to the next were inconsistent and did not add up. After complaints, a general description of the cause was posted on a remote web site. Member records remain inconsistent and only those who notice the unit disappearance get an explanation.

This behaviour was excused by a CLHIO staffer, who said LifeCo “*is widely recognized in the industry as having the most antiquated computer systems in the industry.*”

This is a test case. These issues with LifeCo questionable business practices relate specifically to the proposed CAP guidelines and offer a kind of test case to explore how well the CAPSA proposals will serve the needs of the CAP Members or whether the proposals might simply perpetuate existing practices.

Theme 1: Standardized disclosure on fees and costs and their impact on investment returns

Whenever investors or consumers are offered investment products, such as mutual funds, insurance segregated funds or capital appreciation plans that require them to make investment choices, it is absolutely critical to present information in a consistent manner across all the options. CAPs are far more likely to have unsophisticated investors who otherwise would not hold mutual funds – these people are not knowledgeable investors and should be treated to consistent information.

Recommendation. Here are four critical things that the proposed guidelines ignore, but which belong in the foundation for standardized disclosure:

- Fees should be translated into dollars and the impact of fees fully explained
- The all-in MER should be reported, not some convenient subset such as the IMF
- Tracking Error should be discussed and reported when Seg Funds invest in mutual funds
- Only Net Returns should be reported and Gross Returns should be explicitly avoided

Interestingly, mutual funds and exchange traded funds (ETFs) already have to do this, so it should only be the life insurance industry that needs to bring its practices in line with standardized disclosure. Members compare informational material from a life insurance company to that from their mutual fund company – so the information must be consistent.

End lower disclosure standards for life insurance firms. Today, as our experience with LifeCo shows, the choice of an insurance Seg Fund Service Provider can result a significantly lower standard of disclosure than mutual funds and that would fail 81-102: partial disclosure of fees through IMF; no equivalent to mutual fund impact of fees; no information about tracking error when attempting to replicate the underlying mutual fund; sales material equivalent to a prospectus in exclusively gross return format, often without a fee schedule; fee schedule excludes some funds, comes out months later, possibly in a different medium (e.g. posted in a different website; not included in member statements or sales material, etc.). The aggregate effect of these practices is to significantly downplay the fees and expenses and effectively mislead the employee investor Members.

It is not acceptable that repackaging a mutual fund as a Seg Fund should decrease the quality of investor disclosure. This is not consistent with harmonization. The whole harmonization exercise will be a waste of time from the Member perspective if such broad discrepancies in communication between insurance firms and mutual funds are not resolved.

Fees in dollars. Fees need to be translated into dollars and their impact explicitly disclosed (similar to mutual funds today, to truly harmonize). Percentage fees on assets are too abstract and tend to under-represent the impact of fees, which is more like 10-40% of the expected long run return. Individual member statements should show the dollar amount of fees taken in the reporting periods and any historical period for which performance data is given.

MER not IMF. In the 21st Century, advances in computer technology should make this a relatively simple calculation, but, as LifeCo shows by digging in its heels, harmonization will not result without regulatory pressure.

Tracking Error. Investors who buy ETFs can learn what tracking error is and what impact it might have on their future investment returns. LifeCo packages mutual funds into Seg Funds that contain some cash and a number of units of the underlying mutual fund. Most of the disclosure about the Seg Fund utilizes the (gross) historical record of the mutual fund, including the majority of the performance information. Since the Seg Fund cannot exactly track the underlying mutual fund due to the presence of cash and/or timing differences on purchase and sale of Seg Fund and underlying mutual fund units, this gives rise to a difference in the performance of the Seg Fund and mutual fund. These differences can be large – more than 100 bp -- enough that the Net Return (after fees) in some Seg Funds can be higher than the Gross Return of the underlying mutual funds, for example.

Small Seg Funds or sloppy practices related to creating and redeeming units or maintaining a cash balance for LifeCo fees, can all contribute to tracking errors. Harmonization should dictate that all investments that have tracking error potential be required to disclose it in a consistent fashion.

Net Returns ONLY. There is a well-established mutual fund regulatory process that only NET Returns are reported to investors, and that these are reported only over standardized periods. This is a universal practice in many countries and jurisdictions with a well-established and lasting value protecting investors from sharp practices that mislead them into purchasing high fee mutual funds.

Surely, as regulators, you can appreciate that practices that would mislead investors in mutual funds would have the same or worse effect on investors in Seg Funds and CAP plans. CAP plan investors, are less sophisticated than mutual fund investors (who exercised the choice to invest). Therefore, the onus is on the regulators to see through insurance industry lobbying and protect investors by harmonizing in the most protective fashion by banning gross return performance presentations.

Standardized disclosure exists for lots of financial products. Just as there are standardized information disclosure requirements and terms for other financial products such as mortgage contracts or auto leases that are imposed by government regulation on lending institutions, there

ought to be (but isn't) the same level of standardized information disclosure among segregated fund and mutual fund investment options.

Harmonization should be fixing this rather than perpetuating the status quo.

Theme 2: Timeliness, quality, accuracy and completeness of Member Statements

Recommendation. The Guidelines need to be absolutely clear on some basic business practices around timeliness, quality and accuracy and completeness of Member Statements. Here are four additional critical things that the proposed guidelines ignore, but the Service Provider should be obligated to do:

- Provide clear, accurate and complete statements within 30 days of period end, and at least quarterly
- Report all transactions, unit purchases, consolidations, splits, etc
- Provide Management Expense Ratios, not a subset of the MER such as the Investment Management Fee (IMF) – see Theme 1
- If providing “investment education”, then provide meaningful education about the impact of costs on investment returns

The LifeCo engaged in our CAP performs quite weakly on these dimensions of basic business practice and the Sponsor, YYY Canada, thinks it's just fine that statements may have the wrong valuation date, that units disappear without a trace from one statement to the next due to unreported sub-fund transfers, that IMFs understate the apparent MER by as much as 30-60 basis points, and that LifeCo almost completely ignores education on the critical aspect of the costs of investing. This is not the quality standard CAPSA should be supporting.

Clear, accurate and complete. Clear means understandable, accurate means the dates and prices of valuations and transactions are correct, complete means that all the relevant investment details of a transaction or valuation are reported.

Several years ago LifeCo did not bother reporting the interest rate on a rolled-over GIC. It took several months of letter writing, focus groups, statement redesign, and phone calls to pursue the information after the arrival of each quarterly statement before this practice ended. Our CAP Members were stuck – we couldn't change Service Provider if we thought their “service” was substandard.

Business Ethics 101: a clear accurate and complete receipt – looks like it might need to be required by regulation before LifeCo will deliver.

Within 30 days of period end. Without a deadline, some of these statements can be delayed for quite a while and become jokingly far out of date. There is no reason CAP providers cannot meet the same schedules achieved by other financial service providers, and timeliness should be one of the criteria for selection of a Service Provider.

Report all transactions. With LifeCo, units can disappear without a trace. The Member has to notice that his books no longer balance and initiate an enquiry that takes 6 weeks to get an answer. If he doesn't like the Service Provider, he is not free to choose a better one.

Business Ethics 101 – full, accurate and complete – make it the law or Members will continue to be kept in the dark.

Quality Investment Education must include the impact of fees. This is a governance issue because delegating the investment education role to the Service Provider is fraught with huge conflicts of interest – especially in the matter of the impact of fees. The Member needs the lowest cost effective alternative, while the Service Provider wants to maximize their fee income. This is only partly addressed in Theme 1 under the consistency of disclosure.

A lot more needs to be done to define the minimal standards for “investor education” that CAP investors should get on the impact of fees – dollar amounts, fraction of expected return etc. This will be true whether the Service Provider or a third party does it.

Theme 3: Member participation in CAP governance, oversight and regulatory changes

The captive employee-contributing nature of CAPs requires a higher standard of governance on the Sponsor than other company-paid benefit plans. Our employee Members cannot change the provider selected by the employer, and are subject to economic coercion to maintain their participation in the CAP, regardless of whether they have lower cost or superior investment alternatives.

The big issues ignored in the proposed guidelines are:

- Sponsor conflicts of interest, paternalism and lack of investment expertise
- CAP Member participation in governance and oversight
- Addressing the presence of significantly lower cost alternatives to the CAP

- Delegating education to the Service Provider generates significant conflicts of interest
- CAP Members should have more input in the CAPSA harmonization process because the changes affect them the most

Sponsor conflicts of interest. It is important to realize that CAP Sponsors could have significant conflicts between their business interests with the Service Provider and the interests of the CAP Members. For example, my employer, YYYY Canada sells significant amounts of product and services to LifeCo, the Service Provider of our CAP. How can Members be sure that this business interest did not influence the original selection of the Service Provider (or the ongoing relationship), potentially to the detriment of the Members if the resulting CAP plan is more rigid (to increase assets, and hence fees), or if the management fees are high, or if the terms of the CAP force the Member to deal with the Service Provider?

Members can only hope to manage their employers' conflicts by participating in the design, governance, Service Provider selection and active monitoring of the CAP.

Sponsor lack of investment expertise. When Sponsors contract out all the management aspects of the CAP to the Service Provider, then who is minding the store? Sponsors don't have the investment expertise in house, and YYYY Canada wants to contract out as much as possible. CAP regulations should NOT assume the employer is some kind of sophisticated investor that is capable of protecting employees from sharp business practices employed in the investment provider industry. Rather, regulations should look through the Sponsor and assume that the average CAP investor is LESS sophisticated than the average mutual fund investor and needs greater protection.

Only the regulators and the employees themselves can genuinely look after employee interests. If the Sponsor provides all the contributions (as in our pension plan, for example) the Sponsor may be justified in calling the shots. However, the greater the employee contributions, the greater should be their control and influence over the management, structure and reporting decisions.

CAP Members should participate in governance and oversight. Despite our extensive contributions to our CAP, there is no employee representation in decision making. This is a recipe for bad governance and a model inconsistent with the mutual fund industry, where voting rights, the ability to change Service Provider, and standardized disclosure all help to protect the individual investor to some extent.

What if the CAP is a High Cost alternative for Members? One of the claimed advantages of CAPs is to concentrate capital so as to provide lower cost investment alternatives. This is somewhat of a myth especially for anyone with a modicum of investment savvy. Consider the following examples:

- The range of Effective MERs of funds offered in our CAP is 60-260 bp. The median of 110 bp is about half the public Canadian fund median, but about the same as the US public fund median, yet it still adds up to thousands of dollars to many participants over time.
- Directly held exchange traded funds (ETFs) outside the CAP have MERs as low as 0.17% -- less than a third of the least expensive index fund offered in the CAP and 15 times less expensive than the most expensive funds.
- Bond Fund Effective MERs in our CAP range from 80-180 bp. This is going to be a large chunk of the expected 10-year bond return of about 5%, and is 4-10 times more costly than direct bond ownership.
- Many investment classes are either not represented or represented with very high cost options in the 80+ funds offered by LifeCo, including, income trusts, emerging markets, foreign bonds, etc. Many of the offered funds are brand name funds associated with higher fees.

The investment savvy members in our CAP plan are stuck with the investment ignorant members, with both paying higher than needed fees for a limited range of investment products, while remaining economically coerced to stick with the Service Provider because we cannot switch.

If Members were given a role in governance, lower cost alternatives and the ability to opt out into locked-in accounts at other Service Providers, it could inject meaningful value into our CAP.

CAP Member input into CAPSA Harmonization proposals is needed. Have CAP Members been involved in the discussions to develop the proposed guidelines? Can these regulations help Members if they haven't had significant participation? The appearance is that a large tent is being defined by industry insider Sponsors and Service Providers that will fit every current firm and every current practice into one large house – good for the insiders who hate change; good for the regulators who can claim progress on harmonization to their political masters (who have a very weak grasp on the real issues); but bad for the public who is no better off because there is no real harmonization.

As a CAP Member, I can attest to a variety of questionable business practices that seem likely to continue unabated under the proposed regulatory regime, with the CAP Member no better off in terms of information quality or the ability to challenge or change Service Provider behavior.

Without meaningful CAP Member input, the current proposals are unlikely to have any significant harmonization effect among CAPs, mutual funds and Seg Funds, and therefore are unlikely to serve the public.

Theme 4: Clear regulatory process to resolve Member complaints

Not only are the proposed guidelines vague and subject to interpretation, but there is no process for quick dispute resolution by regulators.

Even supposing a good framework of guidelines arises from this exercise, there needs to be a process laid out for CAP Members to trigger regulatory review and independent third party assessment of conformance by slipshod Service Providers and/or ineffective Sponsors. Already CAP Members don't have a clear point of regulatory review (self regulation being demonstrably useless in the LifeCo case), and this document does not appear to clarify the situation.

Concluding Comments on Proposals

LifeCo maintains it complies with existing and proposed regulations, yet continues to provide service in the bottom decile of accuracy, completeness, and deceptiveness. If these proposals continue to provide a broad umbrella of protection of worst-case performance, it will be a missed opportunity for the Members of our plan.

Many of these proposals are too vague, so firms can argue almost any practice is compliant, fostering an "anything goes" mentality. Loose guidelines that may be intended to encourage "best practices" to evolve can also perpetuate "lowest common denominator" practices that hurt investors, so this CAP Member is urging CAPSA to firm up the guidelines to stamp out questionable practices.

Without significant strengthening, the current proposals are unlikely to have any significant harmonization effect among CAPs, mutual funds and Seg Funds, and therefore are unlikely to serve the public. The public needs clear guidelines not subject to interpretation or abuse, and a clear accessible process for quick dispute resolution by regulators.

Part II: Specific Proposed Amendments to Guidelines

1.3.1 Added Responsibilities of CAP Sponsors

The Sponsor should consider potential conflicts of interest between the interests of the CAP Members and the business interests between the Sponsor and the Service Provider.

The Sponsor should establish processes and procedures for meaningful Member input into the design, Service Provider selection, investment selection, Advisor selection, Member communication and education provisions of the CAP plan. A Member oversight committee is recommended when CAPs involve involuntary or semi-voluntary Member contributions.

The Sponsor should ensure that Members have a reasonable alternative to the selected Service Provider in the event the Service Provider is not appropriate for a subset of Members.

The Sponsor is responsible for monitoring the quality and lack of bias in marketing materials, and especially educational materials prepared by the Service Provider. The Sponsor should be especially careful about Service Provider conflicts of interest related to disclosures and education about the impact of fees and costs on investment performance.

2.1.3 Selecting Service Providers

This section is far too general to be of much use to CAP Members. The Service Provider should be obligated to:

- Provide clear, accurate and complete statements within 30 days of quarter end
- Report all transactions, unit purchases, consolidations, splits, etc
- Provide all-in Management Expense Ratios, not a subset of the MER such as the Investment Management Fee (IMF)
- If providing “investment education”, then provide meaningful education about the impact of costs on investment returns

For captive Members who are forced to make CAP contributions but have lower cost investment alternatives at other Service Providers, the Sponsor should allow the Member to choose a different Service Provider.

2.2.1 Selecting Investment Options

This section must include costs (management fees, expense ratios, loading and switching costs, etc.) as a critical factor when choosing investment options. Cost is not mentioned in the Draft section 2.2.1. Fees are included in 2.2.2, but this is too late in the selection cycle.

Not only does the CAP Sponsor have an obligation to ensure that novice investor Members are not bamboozled into paying excessive fees that compromise their long run return, but Sponsors also have an obligation to ensure that more investment-savvy Members have access to the same ultra low cost options such as ETFs that they would have outside the CAP. Failing to meet the test of providing the lowest cost investment options for the Members means Members are worse off being members of the CAP than they would be outside the CAP – defeating one of the purposes of the plans.

2.2.2 Selecting Investment Funds

As written, the draft proposal calls for investment funds to comply with IVIC or 81-102. This completely ignores one of the most important issues with the lack of harmonization between insurance products and mutual funds – their disclosure requirements are so different.

There may be a gap here because the CAP plan offered by my employer, YYYY Canada through LifeCo, does not offer an insurance component, so it is not an IVIC. It may be an animal outside either of these 2.2.2 definitions.

Any investment fund in a CAP should be called on to comply with a harmonized set of criteria that looks more like mutual fund disclosure in terms of net returns, MER, and impact of fees and costs.

2.3.1 Record Keeping

Record keeping should be of such information necessary to achieve the communication objectives of:

- Providing clear, accurate and complete statements within 30 days of quarter end
- Reporting all transactions, unit purchases, consolidations, splits, etc
- Providing all-in Management Expense Ratios (MER)
- Providing Net Returns

3.2 Investment Information

Fees and Costs and their impact on returns are critical information that should be provided.

4.2.1 Investment Funds

Has industry lobbying ensured that Fees and Costs do not explicitly appear in this most obvious of sections?. Unless the impact of Fees and Costs is taken seriously throughout these guidelines, there will be little net value to the CAP Members.

4.2.2 Other Investment Options

Fees and Costs and their impact on returns are ignored again.

4.3 Description of Fees, Expenses and Penalties

Fees are finally mentioned. From the point of view of harmonization, it is critical that insurance and mutual fund products be directly comparable -- the MER applicable to the Member is clearly disclosed. The IMF is incomplete disclosure. Sample calculations of the impact of fees that are comparable to what is used in the mutual fund industry should also be required.

5.1.3 General Content of Member Statements

There is nothing here that says the Member Statement has to be clear, accurate and complete or that all transactions, unit purchases, consolidations, splits etc. must be reported in a timely fashion. Does that mean that CAPSA agrees with LifeCo that Member Statements can have the wrong date/wrong value, or ignore unit consolidations and splits? Will LifeCo be able to continue these practices and claim conformance with 5.1.3 as proposed? If so, the proposal is too loose.

Rates of Return. All reported rates of return in all promotional material and member statements should be NET of all fees and expenses. The use of gross returns should be prohibited unless exactly the same information is available in the same place/same time/same format in terms of net return.

Impact of Fees. Member statements should show the aggregate amount of fees paid by the Member during the period expressed in dollars, and not just as percentages.

5.2.1 Other Information Available to CAP Members

The wording “details on fees and expenses ...” is way too loose. It is time the insurance firms rose to the quality and types of disclosure required of mutual funds – harmonize as your mandate requires.

5.2.2 Report on Significant Changes in Investment Options

This needs to be tightened up by requiring these details to be available in a reasonable time frame of not longer than a few weeks. For example, LifeCo added a few new funds to our CAP plan 5 months ago (when it gave us gross return histories of the funds), but only now has LifeCo given us a link to a web page said to contain the new IMFs (the link doesn't work yet), and it may be months before we get this information. Was this the schedule CAPSA had in mind for the activities required in this section? I hope not.

5.3.1 Frequency of Performance Reports

This really needs to have deadlines (e.g. 30 days after period end, and at least quarterly) to have much significance. Sometimes LifeCo gives us Annual Report information in July for periods ending 6 months earlier. That is not acceptable.

5.3.2 Report on Fund Performance

All investment performance information should be NET of fees and expenses. Mixing gross and net returns confuses investors and provides opportunities for Service Providers to mislead investors through selective reporting. Since Net Returns are a requirement for mutual funds, harmonization should result in the same standards for the insurance industry.

In addition, there needs to be a common definition of fees and expenses, and MER, which includes everything and is already required in the mutual fund industry should be the requirement. Insurance companies should not be allowed to report IMFs, which exclude certain management costs.

New Section 9: Clear Regulatory Process to Resolve Member Complaints

In addition to the eight sections proposed in the draft guidelines, CAPSA should have a ninth section that lays out the following:

- Procedures to be used by Members to resolve complaints
 - Actions required by the Service Provider to resolve complaints
 - Actions required by the Sponsor to resolve complaints
 - How & When the regulator should be approached for independent 3rd party review
 - What the appropriate regulator is
 - What regulatory criteria will apply in the review of a complaint