Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

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Mr. Davin Hall
Policy Manager
CAPSA Secretariat
c/o Joint Forum Project Office
5160 Yonge Street
17th Floor, Box 85
North York, Ontario
M2N 6L9

Dear Davin:

Proposed Guidelines for Capital Accumulation Plans

Canada's life and health insurance industry gratefully acknowledges the opportunity to comment on the *"Proposed Guidelines for Capital Accumulation Plans"* ("the Guidelines"), as issued by the Joint Forum of Financial Market Regulators ("the Joint Forum") in April, 2003.

As you know, the Canadian Life and Health Insurance Association (CLHIA) and its members have a vital stake in both the public and private pension systems. The industry administers approximately $108 billion in pension and retirement savings plan assets, of which about $53 billion are in registered pension plans. Our members specialize in the administration of small and medium-size pension plans, and about two-thirds of all pension plans in Canada are funded by insurance contracts. Many of these plans offer members investment choice, and therefore fall within the Capital Accumulation Plan ("CAP") regime as well as being subject to pension rules.

As you are also aware, the CLHIA has been an active participant in the industry Task Force charged, in concert with the Joint Forum Working Committee on Capital Accumulation Plans, with developing these Guidelines.

The proposed Guidelines represent many months of thought and intensive drafting efforts on the part of many individuals. Members of both the Working Committee and the Task

1 Queen St. East
Suite 1700
Toronto, Ontario
M5C 2X9
Tel: (416) 777-2221
Fax: (416) 777-1895
http://www.clhia.ca

1, rue Queen Est
Bureau 1700
Toronto (Ontario)
M5C 2X9
Tél. : (416) 777-2221
Fax : (416) 777-1895
http://www.accap.ca

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Force are to be congratulated for their accomplishment. In general, the Guidelines form a useful resource in a shared effort to enhance consistency, integrity and accountability in the CAP marketplace.

The Need for Harmony

The CAP marketplace has very broad scope and encompasses a plethora of plan and product designs and models drawn from a range of regulatory regimes. In many cases, those regulatory regimes overlap, creating duplicate or contradictory compliance requirements. For instance, it is quite plausible that a group RRSP that qualifies as a CAP might incorporate institutional pooled funds administered by a life insurance company as an investment option. While such funds may constitute segregated funds for the purposes of the Insurance Companies Act and the Income Tax Act, they may not be offered to retail consumers via Individual Variable Insurance Contracts. Furthermore, those segregated funds may invest in units of retail mutual funds operated and managed by third-parties. In such a scenario, it is unclear what investment rules apply to the group RRSP. Is it the mutual fund rules under National Instrument 81-102? Is it the segregated fund rules under the CLHIA's IVIC Guideline? Or do no statutory or regulatory rules apply because the group RRSP is outside of the pension regime? Might the plan be guided only by its own terms, however those may have been drafted?

Taking this example one step further, what conflicts would be created if a defined contribution pension plan that offered members investment choice attempted to include such an investment option?

This is simply one example of the types of challenges and opportunities posed by CAPs. While an opportunity clearly exists to create a consistent overarching regime applicable to such plans, it requires exemption from, harmonization with, or over-ride of rules applicable to the constituent parts of the CAP. And it may not be possible to resolve some of these issues independently from other ongoing projects, such as CAPSA's recent consultation process on pension investment rules.

Thus, while Canada's life and health insurance industry applauds the efforts of the Joint Forum to bring clarity to the roles and responsibilities of all CAP stakeholders, the industry is concerned that substantial refinement of the detailed standards contemplated by the Guidelines is still necessary. Moreover, a broad re-evaluation of the confusing interplay of these Guidelines with other relevant legislation and regulations must be considered in order to ensure that the generally effective framework that has already evolved for CAPs is not replaced by an indecipherable web of well-intentioned rules.

Canada's life and health insurance industry sees three challenges that arise from the April 25, 2003 version of the CAP Guidelines:

- Elimination of conflicts and inconsistencies between CAP standards and those applicable to pensions and/or underlying products is essential.

- Efforts to simplify the text and remove seemingly repetitive phrases may have introduced inconsistencies and ambiguities to the meaning of the Guidelines, resulting in a document that is confusing for consumers and sponsors as lay readers and for service providers and regulators as "experts." Clarity and consistency must be restored, and

- Attempts to add rigour and enforceability to the Guidelines appear to have altered the Joint Forum's intention that the Guidelines represent a voluntary, best practice, model, and this intended approach must be reinstated.

Canada's life and health insurance companies are very concerned that the Guidelines, as currently written, would actually be counter-productive, since their ambiguity and regulatory tone may encourage plan sponsors to "opt out" of any form of sponsored savings plan. While this could leave plan members with perhaps more cash compensation, this would be at a higher cost in terms of investing those funds, since CAPs typically operate at lower cost than comparable plans in "retail" markets. If sponsors stay within the CAP regime, the Guidelines seem likely to give rise to unintended and unexpected confusion among all stakeholders, be they plan members, sponsors, administrators, service providers or regulators.

The Need for Clarity

The roles of each of these parties are already self-evident or clearly defined in the Defined Benefit Pension Plan environment (where the plan sponsor is fully responsible for managing the risks) and in the retail market for financial services (where there are clear boundaries between manufacturing, distributing and advising).

In the CAP environment, success depends on the effective collaboration among sponsors, members and service providers who share the common goals of making retirement as secure and comfortable as possible for plan members. In general, Canada's life and health insurers believe that the roles and responsibilities of CAP participants are well understood and appreciated by each party; indeed, industry experience suggests that few Canadians have significant concerns about either the extent or the quality of information and services provided by insurers with respect to CAPs.

Canada's life and health insurers believe that the historical practice of fostering open competition within the marketplace has served CAP participants well. Such competition has enhanced pursuit of best practices by all industry participants, since CAP sponsors have increasingly and inevitably sought out advisors and service providers whose high standards minimize any potential liability to which sponsors might otherwise be exposed.

The Need for Transparency

To the extent that Canadians believe that guidelines regarding additional disclosure or intervention by regulators re CAPS are appropriate, the industry believes that consumers deserve guidelines that are consistent, comprehensive and comprehensible. Clear

definitions of roles for all stakeholders would ensure confidence, and such clarity and confidence are fundamental to the ability of each stakeholder to act responsibly.

Unfortunately, the April 25, 2003 version of the Guidelines incorporates a variety of words and phrases to describe CAP sponsors' responsibilities in respect of disclosure of information to CAP members. In the absence of consistency of usage and precision of definitions, each reader is left to interpret the document in his or her own way. No guidance is provided in discerning the meaning behind different wordings. For instance, what is the difference in the responsibility to "provide" versus "give" or "communicate" or "inform"? Similarly, certain activities "must" be undertaken, but the Guideline then describes what those activities "should" include. These discrepancies are troubling, to say the least.

Canada's life and health insurance companies recognize that the Joint Forum's original goal was that these Guidelines be drafted to be guidelines. They were intended as an outline of the practices which would represent an acceptable standard of practice for CAPs. They were not intended to be drafted as legalistic regulations to be enforced to the letter. (In part, this may have reflected the difficulty of enforcement of a Guideline, absent consensus to adopt that Guideline as a Regulation or Rule in all jurisdictions.) Accordingly, both the Working Committee and the Task Force sought to use consistent, simple language rather than the language of the courts.

Such simplicity can be a powerful tool. In fact, the principles underlying the Guidelines are not complex and the Guidelines themselves can reflect the intent in a straightforward way. Toward that end, Canada's life and health insurers suggest that unintended shades of meaning can be eliminated and enhanced clarity can be achieved by revising the text with two rules in mind:

- All of the terms used will be defined, and

- The same terms will be used consistently throughout the document.

The Need for Efficiency

A further enhancement would be to explicitly declare that the provision of information through electronic means is to be encouraged for its speed, ease of use and manageable cost. This would be consistent with the Joint Forum's own leadership practices with respect to the Task Force and the public generally, whereby the guidelines were distributed electronically and a preference was indicated for submissions to be delivered electronically. This focus on ease of access, cost and timeliness clearly makes modern technology the preferred tool.

Ultimately, good disclosure aims to ensure that intended recipients have access to the information they need when they need it, and in a format they can understand. Each of

the industry's recommended measures would significantly improve the likelihood of realizing that goal.

Some of the life and health insurance industry's concerns relating to the Guidelines have only come to light through distance from the drafting process, and being able to view the document with a more detached perspective. As part of the Task Force, we share responsibility for any such flaws. But many of the industry's concerns reflect changes introduced after consultation with the Task Force had been completed. These changes significantly alter the focus and approach of the Guidelines in a way that is not acceptable.

The Need for a Stand-Alone CAP Regime

For these reasons, insurers believe that a thorough re-evaluation of the April 25, 2003 version of the Guidelines must be undertaken, using the December 20, 2002 version, as revised by the industry Task Force, as a more coherent, accurate and internally-consistent reference. On behalf of the Canadian life and health insurance industry, the CLHIA stands ready to assist in that review.

Attached are detailed comments relating to sections of the April 25, 2003 version of the Proposed Guidelines that Canada's life and health insurance companies believe to be in need of reconsideration These comments are intended as a candid effort to assist in developing a strong Guideline that will be of use to the public generally, and specifically to our members and other stakeholders in the CAP regime. The life and health insurance industry looks forward to further refinements of this document, which the industry hopes will restore a voluntary best practices model as recommended by the Task Force, and result in something that can be incorporated into the industry's standards structures.

In the interim, please feel free to contact me directly should you have questions about our concerns. I can be reached by telephone at (416) 359-2021, by facsimile at (416) 777-1396 or by e-mail at rsanderson@clhia.ca.

Yours truly,

Ron Sanderson
Director, Policyholder Taxation
Acting Director, Pensions and Life Benefits

Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

Detailed Comments re "Proposed Guidelines for Capital Accumulation Plans" as released by The Joint Forum of Financial Market Regulators on April 25, 2003

Introduction

1.1.1. Definition of a CAP

It is unclear why the restriction to "trade" associations was added here and subsequently. Other associations, such as those relating to alumni of a particular university, or to members of a particular religious or other distinguishable demographic groups, may offer CAPs. Exclusion of such groups from the CAP definition essentially creates another tier of products and services where standards of practice and disclosure may not be universally adopted.

1.1.4 CAP members

Throughout the Guidelines references are made to "spouses." If this reference is intended to include common-law partners (i.e., partners of either sex) then clarification and expansion of that term may be appropriate.

1.2 The purpose of the guidelines

The first bullet indicates that the guidelines "describe" the rights and responsibilities of CAP stakeholders. Description may imply a level of completeness or limitation of the CAP that is not intended. The previous text used "outline and clarify" which would appear to provide greater scope, which would seem to be appropriate.

The final bullet refers to a "regulatory result." If the Guidelines are intended to be a voluntary best practice, then "regulatory" does not belong in this sentence – "result" is sufficient. If, however, the intent is to regulate, then it is a misrepresentation to do so under the guise of Guidelines.

1.2.1 Application of the guidelines

Similarly, if the Guidelines "supplement" legislative requirements, then it would appear that they may clarify or add to that legislation; the intent of "supplement" is unclear. If the intent is to impose additional requirements without eliminating any that currently apply, then this is not consistent with the mandate given to the industry task force, and that task force should be reconvened with an amended mandate.

The second paragraph indicates that “The purpose (of the CAP) must be consistent with the terms of the plan.” Since it is the purpose of the CAP that is primary, it would appear that the focus of the sentence in quotations is reversed. Rather, “The terms of the plan must be consistent with the purpose of the CAP.”

While the parenthetic example of the second paragraph may be misleading, (since it is not access to the assets of the plan but access to the cash equivalent value of those assets that is likely to be of interest to the stakeholder), the issue that it addresses is minor relative to the overarching scope of the Guidelines that appears to be the focus on this section. The parenthesized text should be deleted.

1.3.2 Responsibilities of service providers

As with the previous section, the focus here seems to be reversed. The addition of a delegate’s responsibility for “any applicable legal requirements” is unnecessary and inappropriate, particularly if the CAP sponsor attempts to avoid a fiduciary duty. This issue is compounded where multiple service providers perform separate functions, since the Guidelines may be interpreted to create overlapping or conflicting obligations under “any applicable legal requirements.” If the intent is to say that “The CAP sponsor can delegate work to service providers, but cannot escape legal responsibility by shifting it to third parties," then it should be stated as such.

The enforceability of this provision by any regulator is questionable. Ultimately, the enforcement would appear to be via legal action against the CAP sponsor by a plan member. The value of the statement is, therefore, questionable.

Setting Up a CAP

2.1.1 Defining the purpose of a CAP

See 1.2.1 above, second paragraph.

2.1.2 Deciding whether to use service providers

In the CLHIA’s January 15, 2003 comments with respect to the December 20, 2002 draft, the industry indicated that good governance, management and compliance rely not only on necessary knowledge and skills, but also on appropriate management methods and administrative tools. Insurers concluded that knowledge and skills, while necessary, were not sufficient absent such tools. The industry continues to believe that recognition of this “third leg” of the governance “stool” needs to be incorporated in these Guidelines.

The second paragraph appears to create two independent tests, both of which must be satisfied, for all service providers. Since “any advice requested by the CAP sponsor” may be beyond the scope of the tasks delegated to that service provider, this double test may

disqualify some service providers. Surely this test should be qualified as “any advice within their area of expertise.” Otherwise, for instance, a money manager could be held liable under this guideline for advice on how to buy socks rather than stocks!

2.1.3 Selecting service providers

Contrary to section 1.3.2, this section appears to recognize and respect the continued responsibility of the sponsor in regard to the actions of its delegates. This underscores to need to reflect this duty in section 1.3.2.

2.2.1 Selecting investment options

The April 25, 2003 version of the Guidelines correctly indicates that the CAP sponsor has a responsibility to ensure that the plan “offers a range of investment options that is appropriate considering the purpose of the CAP.” The crucial word is “offers,” as opposed to “provides” in the December 20, 2002 version, since “provides” may be construed as “delivering,” or specifying the choices to be made. While the difference is subtle, we believe that “offers” provides greater clarity. The CLHIA fully supports the April 25, 2003 revision in this matter.

The second paragraph indicates that the sponsor may delegate “entirely” the selection of the range of investment options to be offered by the plan. The sponsor thereby appears able to shift any legal liability for that selection to the service provider. This seems inappropriate, given the sponsor’s obligation to ensure that the terms of the plan, including the available investment options, are consistent with the purpose of the plan.

Whereas the second paragraph indicates that a sponsor “must prudently select investment options,” the criteria for that selection, as enumerated in paragraph four, appear to be subjective or optional. Since it is unreasonable to attempt to prescribe the complete range of potentially relevant factors, those criteria must be flexible, and this flexibility should be reflected in the selection methodology outlined in paragraph two. “Must” does not appear to be an appropriate term.

The inclusion of “and selection of” investment options in the second bullet of paragraph four is circular, since the paragraph as a whole lists potential criteria for the selection of investment options.

Insurers applaud the recognition that considerations of diversification, liquidity and risk apply to all CAPs, not solely those with a retirement focus, and the removal of that reference from the final paragraph of the December 20, 2002 version of this section.

2.2.2 Selecting investment funds

A number of responses to the recent CAPSA consultation on the Pension Investment Rules addressed the potential conflict between the investment rules applicable to segregated funds, mutual funds and pension plans. This conflict is again highlighted in

the closing two paragraphs of this section. Harmonization of investment diversification rules, or regulatory acceptance that compliance of an underlying investment with the investment diversification rules applicable to such underlying investments will be considered to be compliance with any alternative diversification level at a plan level should be implemented before adoption of these Guidelines.

2.2.3 Transfers among investment options

A requirement that monthly transfers be provided may be unreasonable given the long-term investment nature of many CAPs and the pricing assumptions of existing plans. It is unclear if there is a presumption that such a transfer would be required to be permitted without specific charges being levied against the member's account.

2.3.1 Record Keeping

Organizationally, it would appear that Item 2.3 – Administration may more appropriately belong in section 6 of the Guidelines.

While all members, sponsors and service providers would hope for and strive toward a "no errors" standard, the reality is that errors will occur and, in some cases, comparatively immaterial errors do not justify the cost of correction. For example, if a Net Asset Value per Share or Unit Value is revised, such a change may actually result in significant processing and administrative cost that will ultimately be borne by unitholders, and this cost may actually exceed the aggregate value of the correction. Put another way, spending $5,000 to correct a $50 error on a $5 billion portfolio may not be prudent or reasonable. Some notion of materiality should be considered.

2.3.2 Retaining documents

It may be inferred that plan members are expected to have access to documents relating to the establishment of the plan. As with other employee compensation documents, this implied broad access may not be reasonable. It may be appropriate to acknowledge that access to the plan details may be restricted on this basis.

Investment Information and Decision-Making Tools for CAP Members

3.1.1 Purpose of investment information and decision-making tools

Provision of investment information and decision-making tools does that guarantee that a CAP member will use such materials in making investment decisions. And there is no guarantee that any materials provided will be useful to the choice given the specific circumstances of any given individual member. Use of terms such as "must" and "will" implies such a guarantee. "Should" and "can" would be more appropriate terms.

3.1.2. CAP member investment decisions

Other than in section 4.1, no consideration appears to have been given to potential plan members and the provision of information and decision-making tools to individuals who are considering participation in a voluntary CAP. As contemplated elsewhere in the Guidelines, disclosure is most effective when provided in advance. That principle should also be applied to potential CAP members.

3.2 Investment Information

Compare to 3.1.1 re the use of "could" versus "will."

3.4.1 Investment Advice - General

Compare "can" in this section with "will" in section 3.4.2. Consistency should not imply any guaranteed result.

3.4.2 Selecting service providers to provide investment advice

Compare "will" in this section with "can" in section 3.4.1. Consistency should not imply any guaranteed result.

3.4.3 Qualifications for service providers who provide investment advice

While professional qualifications and designations may be evidence of appropriate knowledge and skills, they do not, unfortunately, guarantee such knowledge and skills. Similarly, the absence of such formal qualifications and designations does not preclude having appropriate knowledge and skills.

The focus here should be on knowledge and skill, which may be indicated by professional qualifications or designations, and on licencing or other legal requirements, where such licencing or other legal requirements are mandated.

Ultimately, whether a sponsor chooses to consider or retain a particular service provider is a business decision of that sponsor, and many are likely to focus their selection of candidates on those holding professional designations.

3.5 Fees related to investment information, decision-making tools or advice

Whether costs are expressed explicitly or not, costs will inevitably be borne by CAP members, either through transaction-specific fees charged to specific members, or by increased management and administration costs that will typically be allocated to all members in proportion to the size of their investments. Thus, small investors will pay a proportionately smaller portion of such implicit fees, and not be effectively prevented from participating in the CAP due to a large explicit fee.

While Canada's life and health insurers agree that lump-sum fees should not be used to block access to generally necessary information and tools, the determination of what constitutes "basic" information will vary depending on the specifics of the plan and the member group. To assume regulatory enforcement of such subjective standards by any means other than a competitive marketplace focused on best practices is unrealistic.

The reference to "any" information, tools or advice may not be appropriate.

3.6 Privacy rights

It should be noted that any information provided to a CAP sponsor based on a member's consent in writing may only be used for the purposes authorized in that consent.

Introducing the Capital Accumulation Plan to CAP Members

4.1.1 Information on the nature and features of the CAP

To most readers, "must give" is likely to imply physical delivery of a paper document. The reality is that such information is made available to potential consumers, but the choice of accessing such information is left to the potential consumers' discretion. This is a practical and effective means of timely communication with potential and current members of a CAP, available at minimal cost, "on-demand" by consumers.

There appears to be no valid argument for high cost, physical delivery of a paper document that may or may not be desired by potential members. The Guideline should not mandate inefficient communication methods, particularly when section 4.1.2 notes that the members are responsible for educating themselves about the plan and tools.

4.1.2 Outlining the rights and responsibilities of CAP members

Whether a member "ought" to obtain investment advice is a judgment that the sponsor should not undertake. A recommendation to consider obtaining such advice is sufficient and appropriate.

4.1.3 Making investment choices

Does "informed" imply delivery of instructions or access to instructions? This is simply one example of "fuzzy" language that has crept into the April 25, 2003 document.

4.2.1 Investment funds

"At least" in the preamble is unnecessary.

"Material" risk, as noted in the fifth bullet, is subjective; materiality should be defined.

Is identification of an underlying fund required for a "fund on fund" arrangement? It would seem that this would pose a higher risk than in a "fund of funds" arrangement, requiring at least comparable disclosure.

4.2.2. Employer securities

See first two comments under 4.2.1.

4.2.3. Other investment options

What does "Must be given" mean versus "Have access to"? Details and decisions should likely be pluralized.

"Material" risk, as noted in the fourth bullet, is subjective; materiality should be defined.

4.3.1 Information on transfer options

This is but one of the logical inconsistencies between "must" and "should."

Is the list of "possible situations where transfer options may be suspended" meant to be inclusive? While addressed subsequently, reference should be noted here that not all possible situations are in the control of the sponsor or service provider, and that the list is not intended to be exhaustive.

4.3.2 Transfer fees

Taxes are not transfer fees; they would be more logically addressed in section 3.2.

4.4 Description of fees, expenses and penalties

The last sentence of this section would be more clear if it concluded "*such* fees, expenses and penalties should not be aggregated."

4.6 Additional information

"Communicate" and "give" need to be standardized and clarified. "General" is unnecessary and subjective.

Ongoing Communication to Members

5.1.2. Format

"Must be informed" is another nebulous term that needs to be standardized and clarified.

5.1.3 General content

Since many CAPs provide for payday-based contributions that are allocated to numerous different investment options, the reporting of transactions details on a routine statement basis can result in a many-paged statement, with each entry representing a relatively small amount. Whether this statement is supplied as a paper document or in electronic format, this imposes a significant administrative cost that is not typically built into the pricing of the plans. Moreover, industry experience indicates that, in general, both members and sponsors prefer summary reporting being the automatic mode with detailed transaction listings being available on request.

The life and health insurance industry therefore recommends that the inclusion of "transaction details" in the standard statement be in summary form.

The use of "should" is ambiguous and clarification is needed.

5.2.1 Other information available to CAP members

The reference to GICs should also include "and other fixed-term investments"; this will incorporate, for instance, annuities that are not exclusively valued by reference to an insurer's segregated fund.

5.2.4. Adding an investment option

The use of "must give" and "should" is ambiguous.

5.2.5. Removing of replacing an investment option

The tone of this section is inappropriately regulatory in nature given the document's intended status as Guidelines.

5.2.6 Changes in fees and expenses

"Significant changes" is subjective and requires clarification. Do such charges include only explicit transaction charges or also those charges that are embedded in asset-based administration fees, management expense ratios, etc.

5.2.8. Disclosure of relationships between CAP sponsors and service providers

This section (which appeared in the December 20, 2002 version) appears to have been dropped and not integrated elsewhere. Perceived conflicts of interest may still be relevant and require specific reference.

Maintaining a CAP

6.1.1 Monitoring service providers

It should be noted that lower than expected investment yields do not, necessarily, constitute unsatisfactory performance.

6.2.3 Action if there is unsatisfactory performance of investment options

See comment re 6.1.1.

The last two bullets appear to duplicate the same point, unless “alternative: is meant to mean “equivalent.”

6.5.1 Monitoring service providers who provide investment advice

The second paragraph implies a relationship between the advisor and the sponsor that may not, in fact, exist. Whether such a relationship exists or not, the real issue is that “The relationship between an advisor and each individual member is confidential, and no information relating to that relationship will be provided to the sponsor without the specific consent, in writing, of the individual to whom that information relates.”

Termination

8.2 Terminating a CAP Member

This is a personal pet peeve. While the member’s participation in the plan may be terminated, the member is not being terminated, unless his/her death is involved. Reference to the member’s “participation in the plan” would be preferable, even if common parlance is less precise.