



CARP'S BRIEF

TO THE

ONTARIO EXPERT COMMISSION ON PENSIONS

October 19, 2006

INTRODUCTION

Thank you for this opportunity to make CARP's presentation to you.

I would like to make some observations about a number of pension issues that are of importance to Ontarians, and particularly those who are 50 and older.

DEFINED BENEFIT PENSIONS (DBP)

It seems that the main focus of the panel is DBP and in particular their decline as a pension vehicle. I have noted that you have already received many well researched presentations on this issue. Therefore I do not think that we have to belabour the points raised in those other presentations.

Nevertheless, I would like to make a few observations on this subject.

We believe that the challenge to DBP is the result of corporations no longer wanting to undertake long term responsibility for employees' pensions. Therefore, more and more corporations are turning to DCP and variations of Group RRSPs.

We appreciate the value of DBP in that they guarantee the amount of future retirement income. A challenge is whether the amount will be sufficient to enable retirees to maintain a decent standard of living in the future. Compare, for example, the great increase in the cost of living between the past thirty years and today and forecast similar projections into the future thirty years – if present (or past) trends continue, which, of course, is the great unknown.

So, the key to a beneficial retirement income from a DBP is appropriately indexing the future income to the cost of living. But there are problems related to indexation. Are companies

prepared to guarantee indexation? And what measure can be trusted? For example, recently Statistics Canada, which is the source of the CPI on which indexation is based, admitted that they underestimated the real increase in CPI over the last five years.

As a rule of thumb, experts suggest that a retiree needs 50% to 70% of pre-retirement income to enjoy the same standard of pre-retirement living in retirement. How does this apply to a population that is living longer and facing annual inflation?

Lastly, I am reminded of conversations I held a long time ago with a large number of World War Two veterans. They told me that when they were demobed in 1947, the federal government informed them that they would receive a pension of \$100. They were ecstatic because that was a lot of money at that time --- but certainly not 40 years later.

DEFINED CONTRIBUTION PENSIONS (DCP)

DCPs are becoming a popular alternative to DBPs. In our view this should not be regarded as a disaster as considered by some.

In many ways DCPs are comparable to RRSPs --with bonuses: contributions are made to the DCP by both the employee and by the employer who also frequently provides lists of appropriate investments at no charge as an option. Moreover, future retirement income from DCPs may better meet the future cost of living needs of the retiree.

THE PENSION BENEFITS GUARANTEED FUND

This fund is designed to deal only with DBPs that become insolvent. However CARP believes that the fund's mandate must be extended to include DCPs as well as multi-employer pension plans. A number of years ago a multi-employer non-unionized

fund in the cooperative food production industry went bankrupt due to mismanagement and other issues. At the time the Fund only covered unionized pensions, but it now also covers non-unionized pension funds.

The recipients had their pensions severely reduced and spouses even lost their survivors' pension benefits. However at the time, the Financial Service Commission of Ontario (FSCO) could not intervene because of the existing parameters of the Fund. Fortunately a large food producer in the industry came to the rescue of the depleted pension fund and the suffering pensioners. But such situations should not have to depend on the good will – or good luck – that another company will rise to the occasion. (1)

FULL AND PARTIAL PLAN WIND UPS, PLAN SPLITS AND MERGERS AND ASSET TRANSFERS BETWEEN PENSION PLANS

CARP believes that all aspects related to DBPs and DCPs must be explored, including the “fall out” when either type of plan is wound up. This is occurring more and more as Ontario’s manufacturing capacity is becoming “hollowed out.”

When this occurs, members are able to convert their portion of that pension into their own RRSPs in the form of a Locked-in Registered Account (LIRA), which, in turn, can be converted into Locked-In Funds/Life Income Funds (LIFs), Life-Income Registered Accounts (LIRAs) or be used to purchase an annuity. If a LIF is selected, according to the federal Income Tax Act, only a certain percentage can be rolled into the LIF with the balance taken as cash which will be taxed at a rate as if it were annual income—rather than the residue of pension income accumulated over the period of employment. The amounts that can be transferred into the LIF vary by individual.

This current procedure was part of the package of pension changes introduced by the federal government in 1997 in its effort to eliminate the deficit. Prior to that time, the cash balance was taxed on a prorated basis that recognized that it was not annual income. Of course, the deficit is long gone and the federal government has enjoyed a string of yearly surpluses since the beginning of this new century. Accordingly, this policy is no longer needed and must be changed to more accurately reflect the long-term accumulated reality of commuted pensions. Although this policy is under federal jurisdiction, CARP urges the Commission to recommend that, in its quest to ensure “*that [pension legislation] is more responsive to the changing needs of . . . plan members and pensioners . . . [and] is up to date and sustainable,*” the Ontario government pressure the federal government to reform this current policy.

On the other hand, the Ontario government can regulate policies pertaining to LIRAs, LIFs and LIRFs. In fact, in July of this year, it liberalized the process of accessing the principal in LIFs.

Starting in January 2008, an existing LIF can be converted into a “new” LIF, the principal of which can be accessed 25% on a one-time basis and if the application to do so is submitted within 60 days of purchasing the new LIF. Also, Ontario LIF-holders who move outside of Canada for two years can access the entire principal. We don’t know if the current process to access the remaining balance in the LIF through an application based on financial or health distress to the Financial Services Commission of Ontario will remain in force – with the current attendant fees if the submission is approved. Or, if Ontario LIF holders with up to \$17,400 in their principal can continue to unlock them 100%. Finally, a percentage of the principal that is mandated by the federal Income Tax Act must begin at age 71.

To quote from the Commission's description of its mandate: *"the Pension Benefits Act has not been substantially updated since 1986. Much has changed in pensions since then."*

The latter sentence in this quotation is particularly apt in regard to LIFs. Saskatchewan unlocked them 100% in 2002 -- without any reported adverse impacts on former LIF-holders since then. Alberta and Manitoba unlocked them 50%. Federally regulated LIFs can be unlocked 100% at age 90. Like Ontario, New Brunswick unlocked them 25%. A precedent for unlocking LIFs 100% was established in Ontario in 1999 when 61 MPPs were allowed to unlock their occupational pension by 100%.

CARP recommends that the gap between those 61 MPPs (who have been allowed to unlock their LIFs 100%) and the other estimated 450,000 LIF holders in Ontario (who will be allowed to unlock them 25%) must be bridged by allowing all Ontarians to unlock their LIFs 100%. (2)

Professor Jack Mintz, actuary Malcolm Hamilton and financial author and publisher Gordon Pape all agree with CARP's proposal. The following statements are excerpts from presentations made by each speaker at CARP's Media Conference on Unlocking LIFs 100% in Ontario held on September 26, 2007. For the full texts, please see appendix 3:

Professor Jack Mintz: "...100% unlocking, I think, that makes a lot of sense in terms of what Saskatchewan has done. Manitoba and Alberta have 50% unlocking rules. And I think that would make a lot of sense, in fact, I don't see any reason why it shouldn't be anything less than 100%, and that is strictly from a public policy perspective."

Malcolm Hamilton: "... if one looks objectively of what's happened in the 20 following years, we can conclude with great confidence that these [locking-in] rules aren't doing anything constructive anymore."

Gordon Pape: “I wish to strongly support CARP’s initiative to encourage the Government of Ontario to implement 100% unlocking of the assets held in LIRAs, LIFs and other types of locked-in plans.”

By the way, both Professor Mintz and Mr. Hamilton point out that unlocking LIFs 100% will have no adverse impact on the continued existence of Defined Benefit Plans, as some have suggested. (4)

Therefore, CARP urges the Commission to adopt our recommendation to unlock LIFs 100% as part of their final report to the Government in conformity with its objective *“to ensure that [Ontario’s pension legislation] is more responsive to the changing needs of plan sponsors, plan members and pensioners.”*

Conclusion

Let me conclude with one other observation regarding the millions of Ontarians either without pensions or with inadequate pensions or who are dependent for their retirement income on public pensions such as OAS, CPP and GIS supplemented in Ontario by the Guaranteed Annual Income System (GAINS). Indeed, over 700,000 older Ontarians receive GIS (of the 1.5 million older Canadians who receive it). Many of these people have their income “topped up” by GAINS -- which has not been substantially increased in the past 20 years. Any review of the pension system in Ontario (and in Canada, for that matter) must include all those with inadequate or no pensions at all.

Thank you again for this opportunity to present our views on these subjects of vital importance to all Ontarians.

CARP

CARP, Canada’s Association for the Fifty-Plus*, is the largest national association of mature Canadians in our country, representing 250,000 members in Ontario and 400,000 members

across the country. A non-profit organization, CARP does not receive operating funds from any level of government in order to maintain its independence and neutrality. A non-partisan association, carp focuses on issues, not parties or personalities.

Our mission is to promote the rights and quality of life of mature Ontarians – and, of course, Canadians. Our mandate is to provide practical recommendations for the concerns we raise, rather than just “carp” about them.

***Note: CARP’s original descriptor, Canada’s Association for Retired People, has been “retired” because many of CARP’s members are not retired and, since its inception, CARP membership has been available to all people who are 50 years of age and older.**

With the unprecedented aging population, it is more crucial than ever to put effective pension plans into place to ensure quality of life for all Ontarians as quickly as possible. This will also be cost effective for governments, society and communities.

APENDICES

(1) ONTARIO PENSIONS BENEFIT ACT

The pensions benefit guarantee fund is only for Defined Benefit Pension plans. Defined Contribution Pensions are not included. It is also not relevant if the pension is unionized or not. The following section is taken from the pension benefit act. It is the restrictions on the defined benefit pension plans.

Payments not guaranteed

85. The following are not guaranteed by the guarantee fund:

1. The payment of a pension or pension benefit under a pension plan that has been established or maintained for less than three years at the date of wind up.

- 2. Any increase to a pension or pension benefit or the value of a pension or pension benefit that became effective within three years before the date of wind up.**
- 3. The amount of any pension or pension benefit, including any bridging supplement, in excess of \$1,000 per month or such greater amount as is prescribed by the regulations.**
- 4. Pension benefits provided under a multi-employer pension plan.**
- 5. Pension benefits provided under a pension plan that provides defined benefits, if the obligation of the employer to contribute to the pension fund is limited to a fixed amount set out in a collective agreement.**
- 6. Pension benefits provided by prescribed pension plans or prescribed classes of pension plans. R.s.o. 1990, c. P.8, s. 85.**

(2) J . Mintz, “Unlock LIRAS,” *National Post* (FP Commentary), March 27, 2007 p. FP15. Professor Mintz estimated that 1 million Canadians had LIFs. If 45% of the population lives in Ontario, this means that an estimated 450,000 Ontarians have LIFs. No other estimates or actual counts of LIF holders exist.

(3) VERBATIM TEXTS OF SPEECHES DELIVERED AT CARP’S MEDIA CONFERENCE ON UNLOCKING LIFS 100% IN ONTARIO, SEPTEMBER 26, 2007, TORONTO

Professor Jack Mintz:

Thank you very much, first of all, the article that I wrote in the National Post that I wrote a little while ago, I never got so many emails afterwards from various people who had been particularly effected by the provision with respect to locking in of RSPs and pension funds and their ability to access them. And I think one of the saddest is one I received from a women who is currently homeless, her husband had a federal pension, a

military pension, and he passed away and she had difficulty getting access to the locked in pension assets of her husband, As there is a 90 year limitation for pensions, and as a result, she had trouble keeping her accommodations and many other things. I know I passed it on to CARP to see if there is some help that can be given to this poor, poor woman, but it is a very good example of the kind of harm that can be done by a policy that doesn't recognize that the world is changing, and that there are very difficult things that people have to face as they get into retirement.

I am going to talk about the public policy argument for locking in RSPs or not locking them in. I won't be as passionate as the previous speaker, because I look at these public policy issues in very clear criteria as a public policy expert....

What I am going to do first, I will just sit back and ask the questions, suppose a person is working for an employer, and the employer, this is becoming very common these days, an employer contributes to lets say to a group RSP or a RSP plan with an employee, rather than setting up a pension plan, there are two types, Define Benefit Plan, there is a certain amount of money that you get as a pension that is based on your final years at work, a certain percentage of it and the years you work with the employer, and then there is a contribution plan, very much like a RSP, the money that you put into the system, your pension will be based on what you put in and the income that is earned by the contribution plan over time. The contribution plan and RSPs are very similar, in that sense. In terms of what pension income a person can get. But what happens when you get a RSP that is contributed by an employer, or if you leave that employer, and of course in today's world, this is very common, many people leave their jobs quite frequently. That is the way the world is working, because the economy is very dynamic and it's very important to allow for labour mobility. But when the person does leave an employer, and has a RSP, that person can use that RSP as he wishes, subject to the rules of the RSP. That means if something happens and he needs that money and he has to take it out, he can do so, she can do so. It also means at a certain retirement age a person will then use their RSP. That is

what most people usually do, once they put their money in RSPs, they like to use it for retirement purposes. That's not what happens when you have a pension fund when an employee decides to move, as in my case, where I was working at Queens University and went to the University of Toronto.

You don't have an option to put your money into a RSP, the only option you have is putting it into some sort of a locked in fund. In Ontario, there are currently two of them that people have to choose. These are much more restrictive compared to RSPs, in a sense, that when an individual has a locked in fund, the money may have to be kept in the fund longer, there is a certain maximum amount that can be withdrawn from the fund, which is unlike a RSP, so that means if someone is having a difficult time for a year or two they can't access the money at all. In addition, the person who has a locked in RSP, may actually be subject to the rules well beyond the kind of rules that are applied to a general RSP. If you look back on the economic argument for why, or the public policy argument for why, there is very little basis from a public policy perspective.

First of all, the locked in fund actually distorts the market, encouraging more and more employers to move to the RSP method of funding retirement benefits for their employees. Secondly, it can restrict the extent in which employees can save properly for contingencies and life is very unpredictable. Thirdly, it creates a real unfair disadvantage to people who change employers. They have to live under the same conditions as their past employers even though they left that employer and have gone on in life to other employers. These days, if I was advising any employee, I would push very hard to have group RSP offered by firms, rather than be stuck with the kind of restricted basis that is supplied to LIFs coming out of pension funds.

Some people argue that the reason they have these rules is to protect people from not spending their money too early. That isn't what really happens. The problem with that argument is it actually creates a disincentive for people even wanting to save for retirement purpose. Canada has a flexible RSP system. There is a lot of value for people to put money into RSP because they

know they can have access to those funds at any time should some need arise. Most people tend not to withdraw funds out of their RSP at particular times. But there are points when something happens and you need that money and they may do it at that point, take some money out of the RSP, because they may face some real severe difficulties otherwise.

That's been a very important aspect of Canadian policy that's been different from other countries such as the USA, where there are special penalties if you take your money out early from retirement plans and you have to face those penalties. And what that's done in the United States is to discourage people from saving for retirement purposes because they are afraid of locking in their funds.

In Canada, we've have a couple of provinces that have been really progressive on this issue, in particular Saskatchewan. If you read the Income Tax Act, Saskatchewan specifically allows people who quit their employer to have the option of putting their pension money into an unlocked RSP. In other words, 100% unlocking, I think that makes a lot of sense. Manitoba and Alberta have 50% unlocking rules. And I think that would make a lot of sense.

In fact, I don't see any reason why it shouldn't be anything less than 100%, and that is strictly from a public policy perspective. I'll stop there because I know Malcolm will have a better discussion with some of the details involved with locking in Ontario. But I really have become convinced that there is very little argument in favour of having LIFs, and certainly a proposal that allows people to have access to their funds after a certain age would be commendable for any party to undertake.

Malcolm Hamilton:

I am a pension actuary. I consulted two pension plans for almost 30 years now. And the locking in issue didn't arise prior to mid 80's, and it didn't arise because if you were a member of a pension plan prior to mid 80's you couldn't take your money

with you. If you lost your job, as Jack described, and you were vested, you were told you would get a third pension that would start at 65, it would be for this amount, it would be payable for life, and that was the option-- and the only option. And governments decided in the mid 80's that that wasn't good enough. There was too much labour force mobility, to many people getting these annoying little dribs and drabs of pensions when they left five different employers, that people really should have the ability to take their money with them when they change jobs.

And they introduce portability requirements, portability being that if you left the pension plan and you weren't eligible to retire right away, that you could take your money with you. There is a complicated calculation that needs to be done to figure out how much money you would get. But whatever it was, you could take that with you and put it in your RSP. But then they did something that at the time was not very controversial. They said pension money is normally very restricted. You're restricted at what time your pension starts and restricted at what forms it takes and we are going to keep some of those restrictions. Their motivation, -- and they are well meaning people, this wasn't some plot hashed by politicians to deny people value for their pension -- what they were concerned about, I think erroneous, they were concerned that people left to their own devices would use up the money foolishly and when they got to retirement and old age, they would find that they had already spent their pension. So they introduced these locking in requirements, that said you couldn't cash it out and there were limits on how much you could take out every year. They also put limits to protect spouse, They wanted to make sure that the member didn't take their pension and squander it on things that they wanted and die and leave nothing for a spouse. It's important to realize that these rules date back to the 80's and that they were well intentioned at the time they were put in.

I, like Jack, have subsequently concluded over the last twenty years that they were misguided -- well intentioned but misguided. And the proof really was if you look at RSPs. In Canada you have two different ways that Canadians can save for

retirement in a tax sheltered way. There is the pension route that has the locking in and there's the RSP that doesn't have the locking in.

If, as we sit here today, the newspapers were full of stories of people who saved their RSPs and cashed it all out when they were 60, bought a boat, and now they are 68 and are destitute and can't support themselves -- if that was the country we live in, then I think everyone would be saying, what we should do is take the locking in requirement for pension plans and stick them on RSP and make sure Canadians don't waste their retirement saving. In fact, that is not a problem -- which should come as a surprise to no one. Most Canadians who have money in RSPs use it quite sensibly. They don't squander it. They don't waste it. And they don't do things that are financially stupid. They attach great value to that money and they spend a lot of time and energy trying to make sure that they can put it to good use for their family.

There is no reason that pension monies that have been rolled into RSPs would be treated with any less respect. So, it seems to me that the RSP experience and the RSP experiment proves that the vast majority of Canadians left to their own devices will do sensible things.

That in my mind, means that we can really get rid of these cumbersome and restrictive and unnecessary locking in requirements and give people who have transferred money from pension plans into RSPs the same flexibility and the same options and we can extend to them the same respect and confidence that we extend to people with money in RSPs. It is actually quite important because it's not like the government can write a rule that says, here is the precisely best amount for a 58 year old Canadian or a 75 year old Canadian to take out of their RSP. People are all different, some people need their money earlier than other people, some people want to spread their money evenly through retirement, some people want to do things during the age of 65 and 75 that they fear that they won't be able to do later because of health restrictions. Those people may want to withdraw their RSP a little more quickly in the

earlier years of retirement as opposed to the later years. Some people don't have normal life expectancy and these maximum withdrawal rules are set for someone who is in average health. There is an exception for someone who has a got really short life expectancy. But there are a lot of Canadians who at the age of 65 or 70 know that they have a serious health condition that means that their not going to have a normal life expectancy. Their death many not be imminent, they may not have a life expectancy of less that two years, but where a normal person might have a 15 years life expectancy, theirs may be 7 or 8. But telling those people, that they have to live with these constraining maximum withdrawals so that when they die large amounts will be left over perhaps for children who don't need any of it, just doesn't make sense. These rules aren't only unnecessary but they are also inappropriate for a significant percent of the population and they are unnecessarily inappropriate. I am not going to belabor it anymore than that, if there are any questions I will gladly take them after. I am in line with Jack, there was a time when I can see why these rules would have been put in place, but I think if one looks objectively at what's happened in the twenty following years, we can conclude with great confidence that these rules aren't doing anything constructive anymore.

Gordon Pape:

I wish to strongly support carp's initiative to encourage the government of Ontario to implement 100% unlocking of the assets held in LIRAS, LIFs, and other types of Locked-in plans.

This untenable situation exists because of rules that effectively freeze most of the assets in locked-in accounts and prevent the rightful owners of the money from gaining access to it. These laws are a throw-back to the days of paternalistic government and have no place in today's society.

(4) CORRESPONDENCE BETWEEN PROFESSOR JACK MINTZ , MALCOLM HAMILTON AND BILL GLEBERZON ON WHETHER UNLOCKING LIFS ERODE DBPS:

Professor Jack Mintz:

“A person right now can move funds out of a pension fund to put in a Locked-in RRSP. This has no impact on the defined benefit plan since the funds withdrawn are equal to the reduced liability. Unlocking would not hurt existing plan members. Employers and employees can make decisions -- many are looking at group RRSP instead of pension plans as they give full flexibility to employees. Unlocking would create more demand for pension plans as people won't be hurt should they change jobs. Locking-in has terrible effects on some people who can't get their funds.”

Malcolm Hamilton:

“Bill, there are two distinct issues here. One is portability - should members of defined benefit pension plans be able to cash out their pensions? The second is locking-in - if they are allowed to cash out their pensions and choose to do so, should the money they receive be locked-in or should they be able to do whatever they want with it (subject , of course, to the applicable withholding of tax)?

In Ontario, and generally in Canada, pensions must be portable up to the age where a member is eligible to retire. Thereafter, pensions are portable only if the plan chooses to make them so. Some plans allow retiring members to cash out their pensions but most do not. Plan sponsors would oppose extending portability to retiring members because, among other things, the unhealthy members will elect to cash out because they will receive more than they should given their reduced life expectancy. Healthy members will draw their pensions and live for a long time.

In defined benefit pension plans, locking-in is only an issue for those who are able to commute and who choose to do so. From the plan's perspective, once the money leaves the plan it makes no difference whether it goes to a locked-in account or to a not-locked-in account. I favour unlocking amounts and letting people use their common sense. Others oppose unlocking because they believe that people will make irresponsible decisions and end up poor.

From the pension plan's perspective, the important issue is portability, not locking-in.”