Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives

Comments on the Expert Committee's Preliminary Policy Recommendations

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The CAAT Pension Plan thanks the Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives (“Committee”) for holding consultations on its preliminary policy recommendations, published on April 5, 2016.

The CAAT Plan welcomes the opportunity to comment, in its role as a defined benefit pension plan administrator, on the Committee’s preliminary policy recommendations.

About the CAAT Pension Plan

Created at the same time as the Ontario college system in 1967, the CAAT Pension Plan assumed its current jointly sponsored governance structure in 1995. The CAAT Pension Plan is a modern defined benefit pension plan with equal cost sharing between members and participating employers. Decisions about benefits, contributions, and investment risk are also shared equally by member- and employer-appointed representatives to our governing bodies. The Plan is sponsored by the College Employer Council (CEC), the Ontario College Administrative Staff Association (OCASA), and the Ontario Public Service Employees Union (OPSEU). This governance model fosters cooperation and flexibility, and encourages prudent and responsible decision-making.

The CAAT Plan has 38 participating employers serving 42,000 members. The Plan’s employers are mostly from the Ontario college system and also includes the Royal Ontario Museum. The Plan has $8.6 billion in assets to deliver its promise of lifetime pensions to its members. In its actuarial valuation as at January 1, 2016, the CAAT Plan is 110.4 percent funded on a going-concern basis with a funding reserve of $1.2 billion.

The CAAT Plan’s well-diversified investment portfolio has earned a 5-year average annual rate of return of over 9.6 percent, net of investment management fees. The Plan has earned an additional $550 million of value above its benchmark in the last 5 years. The CAAT Pension Plan is recognized by many as a model of a well-managed and well-governed defined benefit pension plan. The success of the CAAT Plan is built on its shared governance and collective focus on benefit security at stable and appropriate contribution rates.

Preliminary Policy Recommendations of the Expert Committee

The CAAT Pension Plan believes that transparency and accountability are fundamental for anyone entrusted with the retirement security of others. Given the Plan’s diverse membership and shared governance structure, the Plan is committed to transparency and accountability. In line with this commitment, the Plan’s funding policy as well as its actuarial valuations, investment policies, and annual reports are posted on the Plan’s website. As such, **the Plan supports the recommendation to apply a statutory best-interest duty to those who provide financial product sales and advice or financial planning**.

Predictable, reliable and efficient retirement income

After making contributions to the CAAT Plan during their careers, members retire with a pension calculated using a formula based on their years of service and their highest average 60 consecutive months of earnings. Members do not have to worry about the difficult and often stressful task of managing an investment portfolio, high fees, misaligned advice, or the volatility of market returns or interest rates when timing their retirement. Through effective and efficient pooling, their pension will last for their lifetime and, if they predecease their spouse, a portion will continue to be paid for their spouse's lifetime. Inflation protection helps to protect their purchasing power over their retirement period. When all of the Plan's features are considered, the average CAAT Plan member can expect to receive 800 percent of their career contributions back in pension payments over their lifetime. The CAAT Pension provides members with a predictable and reliable source of retirement income for life. Thus, a member who retires with a CAAT Plan pension cannot outlive that pension.

Members have options prior to retirement

Not all members retire directly from employment. If a member terminates employment prior to retirement, pension legislation provides that they must be given the option to transfer out the commuted value of their pension benefit into a locked-in retirement account or to another registered pension plan. If they do not exercise that option then they are considered to have a deferred pension, which they can start any time once they reach retirement age. Commuted values are intended to represent the present day value of the future stream of pension payments the member would have been entitled to had they retired from the Plan. As they represent a one-time lump sum payment of a very valuable benefit, these amounts can be very large. However, the deferred pension provides members with a guaranteed lifetime pension that includes survivor benefits and inflation protection. A deferred pension is not affected by market volatility and members do not attract investment and management fees. When members elect to transfer out their commuted value out of the pension plan they must also manage longevity risk when managing their income stream in retirement to ensure they do not outlive their savings.

If members choose to transfer out their commuted value, they assume the investment risk and investment management fees associated with managing the funds. If the investments do not perform well, their retirement fund will be significantly less than what they had in the Plan. Simply put: members who transfer out their commuted value with the intention of investing it to generate sufficient funds to provide an income stream for life are taking a gamble as to whether they will have sufficient funds in retirement to last their lifetime.

Risks may not be understood

Our Plan recognizes the importance of the decisions members must make relative to whether to transfer out their commuted value. To that end, the Plan provides members with information so that they can make an informed decision about which option to choose.

Anecdotally, Plan staff is aware that members have been encouraged to transfer out their commuted values by many financial advisors because they are told that they can earn a better retirement income with their advisor or have more flexibility or control. This investment strategy may include unrealistic return assumptions and Plan staff question whether the member has been fully informed of the investment fees and risk that will be taken on compared to the low-risk and no-cost deferred pension option that exists with the Plan.

The CAAT Plan favours more transparency and accountability in such interactions. Specifically, the Plan supports the recommendation to apply a statutory best interest duty to all individuals and firms that provide Financial Product Sales and Advice and/or Financial Planning in Ontario. If financial advisors are encouraging clients with a defined benefit pension plan to commute the value of their lifetime pensions, they ought to have a duty to act in the best interest of clients and to disclose any conflict of interest, including all direct and indirect compensation they will receive. **The CAAT Plan favours the mandatory disclosure of investment fees and commissions and a clear explanation of the investment and other risks being borne by the client.**

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Financial advisor performance

A number of studies raise doubt about the payback of counsel by financial advisors. The recent issue of *The Ambachtsheer Letter* (May 2016), cites research from the University of Chicago, Northwestern University and Western University, where clients with financial advisors underperformed their passive benchmarks by an average of 3 percent per year.[1] These findings lead the researchers to conclude that in too many cases, advisors are drawn into the industry with the misguided strong belief that the combination of high-fee funds and high turnover will improve investment performance.[2] It's been the experience of the CAAT Plan that defined benefit plans are more likely to add value over their benchmarks.

In addition, the investment performance of former plan members and their financial advisors fared poorly when compared to the investment performance of a DB pension plan. A study by the Teachers Retirement System of Texas (2011) looked at converting DB plans to self-directed defined contribution (DC) arrangements. The study found that in any DC plan with a self-directed component, 92 percent of members would do worse, and a startling two-thirds would do significantly worse, receiving 60 percent or less of the current DB benefit.[3]

Alignment and knowledge

The CAAT Plan has also been contacted directly by advisors who would like to know how much their client has in his or her pension "account." This question assumes that the member is in a group RRSP or defined contribution plan in which members have a personal retirement fund. In these cases, the advisors demonstrate little to no knowledge of how a defined benefit plan works and the value of the benefit to which their client is entitled. For this reason, **the CAAT Plan is in favour of regulators ensuring that any minimum level of proficiency and expertise includes an understanding of a range of retirement savings options – including defined benefit pension plans**.

Along with more disclosure, **the CAAT Plan also supports the Committee's recommendation for financial literacy and investor education**. The CAAT Plan notes that enhanced financial literacy and investor education would also be beneficial for those with a workplace defined benefit pension plan as it would help members understand the value of their pension benefit, make decisions about other retirement savings, and feel more secure when it comes time to retire.

Summary

As a pension administrator, the CAAT Pension Plan is ultimately in the trust business. It has a statutory obligation to administer the pension plan in the best interests of its members. The CAAT Pension Plan believes financial advisors working with the retirement income of their clients need to be held to a similar standard of accountability and transparency. If a financial advisor is encouraging clients with a defined benefit pension plan to commute the value of their lifetime pensions, the financial advisor ought to have a duty of care to act in the best interest of clients and to disclose their conflict of interest and the risks the clients are assuming.

The CAAT Pension Plan thanks the Committee for this opportunity to comment on its preliminary proposals.

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[1] Keith Ambachtsheer, "The Ambachtsheer Letter (May 2016)," *KPA Advisory Services LTD.*, http://kpa-advisory.com/the-ambachtsheer-letter/current.
[2] Ambachtsheer, 2016.
[3] Robert L. Brown and Craig McInnes, "Shifting Public Sector DB Plans to DC: The experience so far and implications for Canada," *Canadian Public Pension Leadership Council*, October 2014, https://cpplc.files.wordpress.com/2014/09/db-vs-dc_plans_research-paper_2015-errata.pdf.