

# A Time for Questions

Glorianne Stromberg looks at the Joint Forum Proposals and the CAPSA Papers<sup>1</sup>

The growth of defined contribution plans in Canada has created new pressures for plan sponsors and plan members alike, as well as for the various financial services regulators. In response, the Joint Forum of Financial Market Regulators (Joint Forum) and the Canadian Association of Pension Supervisory Authorities (CAPSA) have issued papers proposing significant changes to the regulatory framework governing Canadian pension plans. The Joint Forum's "Proposed Regulatory Requirements for Capital Accumulation Plans" and CAPSA's two papers, "CAPSA Pension Governance Guidelines and Implementation Tool" and "Proposed Regulatory Guidelines for Electronic Communications in the Pension Industry," are all available on the CAPSA web site.<sup>2</sup> The proposals aim to develop a new regulatory model that ensures plan members receive access to the information, tools, and assistance they need to make sound investment decisions. Both CAPSA and the Joint Forum have asked the industry for their comments on these papers. In remarks made at a conference last fall, Glorianne Stromberg highlighted the importance of taking this opportunity to look at the proposals and to give CAPSA and the Joint Forum your feedback. She shares her own reaction to the proposals in the following question and answer session with *Canadian Investment Review*:

## What key principles is the Joint Forum proposing for the regulation of defined contribution plans?

The key principles of the Joint Forum's proposed regulatory model cover a number of requirements concerning the establishment and maintenance of any capital accumulation plan, including the selection of a reasonable range of investment options, investment

managers and related monitoring requirements. They also address the provision of detailed initial and continuing disclosure to plan members and the imposition of fiduciary obligations on providing investment decision-making tools, including requirements that plan members deal with a registered sales representative or advisor or otherwise receive appropriate assistance with investment decisions. The proposals also cover the need to ensure that each investment option meets minimum investment rules and that plan members are not subjected to any greater risks than investors in retail mutual funds or segregated funds.

## In your view, are the Joint Forum's proposals going to be effective?

The proposals are certainly well intentioned and it would be easy to let yourself be lulled by the reasonably straightforward, common sense articulation of basic principles. But the devil is in the details that you will only find if you read the three papers together. I have concerns about the likelihood of the proposed requirements in their present form adding much to the ability of plan members to meet their retirement needs. In fact, they may well discourage employers from making capital accumulation plans available through the workplace.

## Why do you think they may discourage employers from making capital accumulation plans available?

The Joint Forum's principles of regulation rely on and perpetuate some of the worst features of the securities and insurance regulatory regimes – features that we know are falling short of meeting the needs of the marketplace. In addition, the principles

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involve elements of subjectivity that give plan sponsors no certainty as to whether they have fulfilled their duties and responsibilities. In these circumstances, it is unrealistic either to give or to deny a safe harbour. The principles place an impossible burden on plan sponsors and offer no assurance to plan members of meeting their retirement goals. This makes no sense and indicates that something is wrong with either or both of the regulatory requirements and the plan design.

### What do you mean by “impossible burden”?

The DC plan model has some serious design flaws. These were masked by the euphoric mania that dominated the prolonged bull markets of the '90s. People who think deeply about these plans voice real concerns about the employee's ability to comprehend and prudently manage the investment risk that defined contribution plans place on the employee. There has been little consideration of the appropriateness of requiring or encouraging employees to rely solely on defined contribution plans (as currently structured) to provide an assured employment-based stream of retirement income. In fact, there is concern about whether employees, as a term of their employment, are being required or encouraged to accept what is an inherently unmanageable and, therefore, inappropriate risk. If this is so, it leaves employees vulnerable. It also leaves the employer vulnerable and accountable.

When you focus on the design flaws of defined contribution plans, it is unlikely that plan members are going to derive much benefit from regulators treating these plans as if they were commoditized investment products and imposing the prospectus and registration requirements of securities laws on them. The issues of disclosure, advice and suitability are much more systemic and complex.

### Should governance requirements vary according to the size of the plan?

I have heard some people suggest that governance standards should not be the same across the board. No one would ever suggest that the standards for electrical equipment should vary according to who the user is. Standards should not vary depending on the number of

employees. However, the means for satisfying these standards may (and will need to) vary depending on the number of employees and how the plans are structured.

### Does the CAPSA Governance Guideline make enough of a distinction between Defined Benefit and Defined Contribution plans?

The CAPSA Governance Guideline seems to be drafted primarily with defined benefit plans in mind. It would be helpful if this Guideline were reformulated to distinguish the requirements that apply only to defined benefit plans from those that apply only to defined contribution plans and those that are of general application to both types of plans.

### Any words of advice for plan sponsors offering investment choices or selecting investment managers?

Watch costs! In offering investment choices or selecting investment managers, keep a close eye on costs. They do matter. Each one per cent that is eaten up by costs reduces end capital value by about 20 per cent after about 20 years. Look very carefully at wrap programs, cloned funds and other fund-of-fund arrangements and ask yourself how many times a person needs to pay for “advice” and professional management. Also take a close look at these arrangements. Some of them give rise to fundamental questions about the sufficiency of their governance arrangements and raise fairness issues. Look very carefully at their operating or implementation costs. These costs don't show up in management expense ratios but they can decrease investment returns by another couple of percentage points. Operating inefficiencies are often the result of inadequate governance procedures. These are measurable and the shortfalls are costing Canadian investors, both large and small, dearly. It will not likely be long before there are people turning to plan sponsors and money managers to recover this difference. This could cost you real money so it would be prudent to start focusing on this now to be sure the problem does not arise.

### Endnotes

<sup>1</sup> This article is based on remarks made by Glorianne Stromberg at the INFONEX Canadian Pension and Investment Industry Summit, November 5 – 6, 2001. A full version of Ms.

Stromberg's remarks can be found on the Canadian Investment Review web site, [www.investmentreview.com](http://www.investmentreview.com)

<sup>2</sup> [www.capsa-acor.org](http://www.capsa-acor.org)