National Report for Canada
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Canada

In the report to IACA for 1992 the writer quoted from an article in the *Financial Post* which said in part:

> "The world will finally take notice of Canada in 1992"

Well 1992 is now long past and it seems that with the possible exception of those who are interested in ice hockey the world has largely ignored Canada as usual.

However, the world of Canada since 1992 has changed considerably, we are now part of the North American Free Trade area and once again we are led by a Liberal government. The Tory government of Brian Mulroney distinguished itself by devoting most of its endeavours to obtaining changes to the Canadian constitution. The result of years of debate and discussion was a proposal for change so complex and wide ranging that no Canadian had difficulty finding some aspect of it that they did not like. As a result it was voted down and we continue with our somewhat flawed Constitution that continues to upset Québec.

Mulroney passed the reins of his party on to Kim Campbell, who became the first women prime minister of Canada. She distinguished herself by leading her party into the biggest ever electoral defeat by going from a majority to only **TWO** seats in the House. Thus, we have the unusual situation that Her Majesty's Loyal Opposition is led by an avowed separatist, Mr. Lucien Bouchard of the Bloc Québecois.

The fact that Mr. Bouchard parades across the country addressing Chambers of Commerce and any other forum telling them to get ready for Québec independence does nothing for investor confidence or the Canadian dollar. The latter continues to drop and the former varies tremendously by region and sector. The various bond rating agencies continue to downgrade our bonds while our national debt, fuelled by a do nothing Liberal budget, continues to rise into stratospheric regions. Unemployment continues to plague the country, official rates are 11%, or thereabouts, but in some parts of the country, such as the Maritimes, the local rate is far higher. Youth unemployment continues to be a major issue and in some cities unemployment among the 18 to 25 age group is as high as 40%.

Employers wrestle with competitors in the global economy. Changing lifestyles lead to different work habits, with many trying to work less than full time. Defined contribution pension plans continue to replace defined benefit plans. Employers apply constant pressure to reduce the fees of traditional actuarial work. Real estate problems have caused the collapse of two smaller life companies and severely affected the financial strength of some majors. With all these issues and events. consulting life continues to be interesting and challenging.

Economic Background

Some key economic indicators of Canada's situation are:

	December 1991	December 1992	December 1993
Exchange rate $1 Cdn. = $ U.S.	1.16	1.27	1.33
Consumer Price Index 12-month increase	3.8%	2.1%	1.7%
Unemployment rates Canada	10.3%	11.5%	11.2%
Interest rates T-Bills 91 days Long term Government bonds Long term Corporate bonds	 7.24% 9.05% 10.03%	 7.00% 8.83% 9.71%	 3.85% 7.45% 8.08%
Equities TSE 300 composite	3,512	3,350	4,321

For many consulting actuaries the rates of return in the various sectors of the economy are of interest in their pension work. Below are some benchmark returns:

	1991	1992	1993	3 yrs
Common stocks (TSE 300 Composite)	12.01	-1.43	32.55	13.53
ScotiaMcLeod Universal (bonds)	22.14	9.84	18.14	16.59
ScotiaMcLeod 91 day T-Bills	9.83	7.08	5.51	7.46
Median Pension Fund (Mercer)	17.20	7.22	21.60	15.18

Social Security

The combination of social security programs that are provided to virtually all Canadian residents continues much as before. As the various programs are a blend of initiatives between the Federal and Provincial governments, they are constantly being tinkered with, as the two levels of government try to reduce their deficits.

Retirement Pensions

The two levels of retirement pensions continue as before. Canadians who have 40 years of residence, or who qualify under a grandfathered clause, receive the Old Age Security at the rate of $385.81 per month. Although there is no means test to receive the pension, the old age security pension is taxed back for those with annual incomes of $53,215 or more, by the so called "clawback" provision.

Both the Federal and Provincial governments operate supplemental pension programs, subject to a means test to provide minimum levels of income. All of these benefits and the basic Old Age Security pensions are financed from either the Federal or Provincial tax revenues.

The second level of pension is the earnings related Canada Pension Plan (CPP), or its essentially similar counterpart, the Québec Pension Plan (QPP). This program is designed to provide a pension of approximately 25% of the average industrial wage. For people retiring at age 65 in January of 1994, this program will provide a pension of $694.44 per month. For 1994 the average industrial wage is $34,400 per annum.

The CPP and QPP can begin between the ages of 60 and 70. For those who draw them before age 65, the pension is reduced by ½% per month early and for those who postpone their retirement it is increased by ½% for each month. The plans both provide substantial benefits for widows, orphans and those who become disabled.

The plans are funded on a pay-as-you-go basis and recent projections have indicated that the current level of contributions of 5.2%, shared equally between the employer and the employee and scheduled to increase to 10.1% by the year 2016, will not prove adequate. This has led to discussion of a variety of measures to reduce the costs because it is unlikely that future generations will be willing to bear such a high burden to pay for the retirement pensions of their parents' generation.

The Canadian Institute of Actuaries (CIA) has been a major participant in the discussion of possible changes. At this stage it is not clear what direction the Government will follow but suggestions that the normal retirement age be moved up have been made. As most pension plans that provide defined benefits are integrated with the CPP and QPP changes to those programs will impact on private sector plans.

Other Social Security Programs

Although the Canadian national system for medical and hospital insurance covering all Canadians is often held up as an example of how to operate such things, it is not without its problems. To a large extent the problem is created by the two levels of government both trying to reduce costs. The Federal government have in effect capped their costs, so that the Provincial governments are forced to cut theirs.

The medicare system covers all basic services that are normally required, other than routine dental care, prescription drugs (for those under 65), and some costs for vision and hearing care. This leaves scope for employers to provide supplementary coverage beyond the basic.

In an effort to cut spending, governments have shifted costs from the provincial healthcare plans to employers and employees. Several provinces have made changes that include some combination of the following:

- de-listing previously eligible drugs (for those over 65);
- increasing deductibles;
- decreasing reimbursement levels; and
- reducing out-of-country coverage.

In most cases, whatever is cut out in the Provincial plan is picked up in employers' supplementary plans.

Tax increases announced in 1993 in both Ontario and Québec directly impacted group insurance programs. Ontario extended its retail sales tax, currently 8%, to group life and health premiums. The tax also applies to costs paid under self-funded arrangements. In Québec, which has a different tax regime than other provinces, premiums paid by employers for group life and health programs are taxable benefits to employees. It was widely rumoured that the Federal government would follow the Québec model in its 1994 budget but it in fact backed off for now!

Unemployment Insurance

Unemployment insurance benefits are provided under a Federal program. As well as unemployment benefits to those who have lost their jobs, the program also provides some short term sickness, maternity and parental benefits. As with other social insurance programs, costs have been increasing dramatically and the government have been forced to introduce cost control measures.

Among the measures introduced in the last two years are a reduction in benefit level from its previous 60% of insured earnings to 55%, extending the minimum period of time that an employee must work to qualify for full benefit, and reducing eligibility for those who voluntarily quit their jobs or are dismissed for cause.

The new Liberal government reversed some of the changes introduced by the outgoing Tories so that the 1995 and 1996 premium rate is to be reduced from $3.07/$100 of insurable earnings to $3.0/$100. In 1994 insurable earnings are a maximum of $40,560 so the premiums paid are $1,245 by employees and $1,743 by employers. The maximum benefit is now $428.00 per week. This measure was introduced in an attempt to reduce payroll taxes and stimulate job creation. It ignores the basic concepts of insurance as the UI fund has a large and growing deficit.

Workers' Compensation

Workers' compensation programs run by each of the provinces are available to employees primarily in industrial occupations. Almost without exception, the provinces are in severe financial difficulties with large unfunded liabilities. Thus they are resorting to a variety of measures to try and reduce costs. The most extreme situation is in Ontario where a whole new rating structure has been introduced to try to more accurately reflect the exposure to risk. So far it has met with mixed success and the unfunded liability continues to increase.

Private Pension Plans

The incredibly complex tax environment, introduced in 1990 supposedly to provide equal tax assistance for those who participate in defined benefit programs and those in defined contribution plans, continues to stifle the growth of defined benefit plans. In fact the effect has been to cause the wind-up of many small and medium size defined benefit plans.

With British Columbia introducing its Pension Benefits Standards Act in 1993, most of which came into effect in 1994, all of the provinces have now introduced pension legislation. Unfortunately, despite well meaning efforts by the bureaucrats operating the legislation, and pleas from the consulting fraternity, the provincial legislation is far from uniform.

All pension plans must be registered twice, once under provincial laws, or a similar law for certain federally regulated employers, and again under the Income Tax Act with Revenue Canada. As if double registration were not a problem, an employer who operates in more than one province must comply with the minimum requirements of each province in respect of its employees in each province.

The amount of reporting, and the complexity of operating defined benefit programs, is largely blamed for the fact that the most common way for smaller employers to help their employees with retirement savings is to operate a group registered retirement savings program. The only "group" aspect of these programs is that if contributions are required of the employees they are handled by payroll deduction and the expenses are pooled thus providing some economies of scale. The plans are in fact a series of linked individual saving programs. The key element of these is that plans are pre-registered with Revenue Canada and no provincial registration is yet required. A number of provinces have indicated that they are not happy that Group RRSPs escape registration and have indicated a desire to bring them under their jurisdiction. A key concern of the provinces is that Group RRSPs are not locked in. That means that an employee can elect to withdraw the savings at any time. In the long run this would mean fewer people have adequate retirement income and could thus become a burden to the social security system. While regulators see the withdrawal feature as a problem, most plan members see it as an advantage.

Several of the provinces are either in the middle of, or about to start a review of their legislation. The Federal government has also indicated a start to their review of the tax assistance afforded to retirement plans. The CIA has implemented a task force chaired by a senior pension practitioner to assist the government develop its thinking.

Despite all the studies and the introduction of pension reform to the tax system in Canada, the maximum level of pension that can be provided to high earners remains at the 1975 level, of approximately $60,000 per annum. This has led to an increase in the number of supplementary executive retirement plans, or SERPs. Such plans provide some interesting conundrums for consulting actuaries.

Under our Income Tax laws if the employer sets monies aside to meet the obligations of SERPs they create a new kind of entity, a Retirement Compensation Arrangement or RCA. One of the features of RCAs is that 50 cents of each dollar that is contributed must be deposited with Revenue Canada in the form of a refundable tax. The tax is refunded once benefits are paid at the rate of 50 cents for every dollar of benefit. This regime of 50% refundable tax, which also applies to the investment income of the fund, is widely regarded as penal. It has led to the introduction of a number of different approaches, the most common probably being pay-as-you-go, i.e. the employer makes no advance funding to secure the promised benefits. This has led, in some circles, to concern by executives that there may in fact be no funds to pay their pensions. The Letter of Credit (LC) has become a fairly popular way to provide some measure of security. The LC is issued for a face amount equal to the full actuarial liability of the plan and is payable if the employer defaults on the pension promise or fails to renew the LC. Revenue Canada has ruled that where an LC is used, it is only the premium, paid to the issuing bank, that is subject to the refundable tax not the face value of the LC.

While on the subject of SERPs another change, introduced in the last few months of 1993, is the requirement for companies whose shares are traded on the Toronto Stock Exchange to disclose the total compensation of the top five earners. This has led to the disclosure of some SERPs which may otherwise have not been apparent to the shareholders.

With the changes going on in the pension area there still remains ample opportunity for consulting actuaries to provide their advice to clients. However, it is interesting to note that the mainstay of the actuarial business in past years, the actuarial valuation, has now become a price sensitive commodity. The proliferation of small actuarial firms in the market place has driven the price down to as low as 40% of its former level. The price collapse is a significant concern for the major consulting companies, who have invested millions of dollars in systems and checks and balances to ensure the delivery of a quality product that meets the requirements of the CIA and their own professional standards.

Financial Institutions

Changes to the regulations under which Banks, Insurance Companies and Trust companies operate in Canada has led to significant changes to the ownership structure of the trust industry. All of the major banks now own a trust company. Possibly the most significant pairing was the purchase by the Royal Bank, Canada's largest bank, of the Royal Trust Company, Canada's largest trust company. The combination ranks the new institution as one of the largest in North America. It remains to be seen what impact these super institutions will have on the Canadian pension industry.

There is also concern that the banks, with their extensive branch network, will become a major threat to life insurance companies.

Many of Canada's financial institutions continue to be plagued by the impact of the downturn in the real estate market. The widely published demise of real estate giants, such as Olympia and York, has had a significant spin-off effect on insurance companies, trust companies and banks. Real estate problems were the main reason for the collapse of two of Canada's smaller life insurance companies and has led to the restructuring of one of the largest mutual life companies. The problems caused by the real estate collapse were a major reason why the banks were able to acquire trust companies, often at fire sale prices.

Questions about the financial stability of our institutions are far from over as the credit rating agencies continue to downgrade their ratings. This leads to increased concerns on the part of employers who naturally turn to their consulting companies for advice in this very sensitive area.

Professional Issues

As of June 1993 the membership of the institute was:

Fellows	1,789
Students	1,225
Correspondents	42
Other & Inactive	9
	3,065

The percentage distribution by class of employment is:

Insurance companies	50%
Consulting	42%
Government	4%
Other	4%

For some time now the CIA has been wrestling with the changes to the disciplinary process. It was felt that in order to preserve our status as a self-disciplining professional body, we had to have a process that was more visible and yet fair to the members. This has led to a number of changes in the process for instituting an investigation into the conduct of a member. Perhaps three of the many points of the new procedures worthy of note are that, if a complaint proceeds to the stage of a tribunal, the tribunal is chaired by a retired judge, its hearings are open to the membership and any other interested party and the results are published.

Finally, the "snitch" rule, that was referred to in the last Canadian report to IACA 92, was adopted and is now in place. Except in certain specific circumstances an actuary is obliged to report any material departure from the CIA's rules or standards to the CIA. This has created more work for the disciplinary committee.

The various committees of the CIA continue to work on the issues of how professional work should be performed. This has led to the publication of new recommendations on how to compute transfer payments from pension plans upon termination of membership and a new set of recommendations for the valuation of pension plans. During the last two years several "Valuation Technique Papers" have been published on different aspects of our work including Dynamic Solvency Testing for Life Insurance companies, among several to do with life insurance.

An interesting project that one committee of the CIA is working on is the development of consolidated standards of practice. This mammoth project which has been in progress for several years, is an attempt to combine all the professional standards of the CIA into one. Thus, instead of having a different standard of practice for setting assumptions for each type of work that we do, actuaries will in future apply the same standard. This does not mean that the same interest rate, as an example, will be used for all work but rather that the approach to determining the rate would be standardized.