

# Modernizing the guidelines for capital accumulation plans (CAP Guidelines)

## Summary

In this paper, we examine the proposed updates to the CAP Guidelines issued by the Canadian Association of Pension Supervisory Authorities for capital accumulation plans. We provide a background and overview of the current guidelines, look at what has changed since the guidelines were introduced, and the possible impact of the latest proposed updates on sponsors, plan administrators, members, and advisors. Finally, we discuss the role of good CAP governance in the success of CAPs and suggest areas where advisors can help CAP sponsors and administrators establish and maintain a robust governance framework.

### **Key takeaways**

- The CAP Guidelines provide a streamlined framework for setting up and managing successful capital accumulation plans in Canada.
- A process is under way to update the CAP Guidelines for the first time since 2004. These updates will likely have a significant impact on sponsors and advisors based on the latest draft.
- CAP sponsors and administrators often rely on service providers to meet some of their obligations to plan members. There are many key areas where advisors and consultants can help plan sponsors in setting up and maintaining a CAP.
- Strong CAP governance assists plan sponsors in building successful CAPs and protecting them from future liability. At the same time, it helps members maximize the value of the CAP to them.

## What are the CAP Guidelines?

The CAP Guidelines were adopted in 2004 to codify consistent rules for capital accumulation plans (CAPs) across the country. They were introduced by the Joint Forum of Financial Market Regulators (Joint Forum) and included the participation of all pension regulatory bodies (CAPSA) and related insurance and securities regulators.

The challenge with regulating CAPs is that they're governed by different federal and provincial laws across Canada, depending on the plan. The CAP Guidelines were intended to introduce new standards for all CAPs, regardless of the type of plan or the jurisdiction.

With such a fragmented environment, amending all legislation governing CAPs would've been an extremely difficult task. The CAP Guidelines made it possible to implement shared standards across the country without requiring a Canada-wide legislative harmonization. CAPSA adopted the CAP Guidelines and issued CAPSA Guideline No. 3 governing defined contribution registered plans.

While they're not formally incorporated in legislation, the CAP Guidelines reflect the final word from CAP regulators regarding their expectations or standards for operating a CAP. Courts are expected to look at these guidelines as the generally accepted standard of conduct.



## Who is CAPSA?

The Canadian Association of Pension Supervisory Authorities (CAPSA) is a national association of all provincial and federal legislators that oversee pension plans, including the Canada Revenue Agency.

CAPSA issues guidelines for the standards that it expects plan sponsors and their service providers to meet when operating a retirement plan.

While these guidelines aren't pension legislation, which is adopted through provincial legislators, they provide a useful framework of best practices for pension fiduciaries and service providers to follow across Canada.

# Summary of current CAP Guidelines

The key message of the CAP Guidelines to the industry is that the responsibilities of a plan sponsor go beyond setting up the plan. To that end, the CAP Guidelines are intended to:

- Outline and clarify the rights and responsibilities of the key CAP players. These include the CAP sponsor (typically the company offering the CAP), the service providers, and CAP members. In the case of a registered pension plan, many of the responsibilities of the sponsor described in the guidelines are those of a pension plan administrator.<sup>1</sup>
- Ensure that CAP members are provided the information and assistance they need to make investment decisions in a CAP.<sup>2</sup>

## Setting up a CAP

The CAP Guidelines state that sponsors should clearly define and document why the CAP is being established. Examples of purposes include saving for retirement, tax-efficient compensation, profit sharing, and saving for other financial goals.<sup>3</sup>

Sponsors must decide whether to use service providers to carry out certain tasks set out in the guidelines.<sup>4</sup> These tasks can include recordkeeping, investment selection, fee negotiation, ongoing fund monitoring, plan member onboarding, and education. In the case of recordkeeping, for example, this can encompass payroll interface, assistance with compliance and documentation, communication and education, comprehensive investment lineups, and member advice. Typically, all but the largest sponsors employ a third party to assist with recordkeeping.

When a sponsor decides to delegate a task to a service provider, ultimate responsibility remains with the sponsor. Sponsors must therefore choose their service providers judiciously and retain oversight for the tasks the provider is carrying out in their name.

All footnotes referencing sections of CAPSA Guideline No. 3, Guidelines for Capital Accumulation Plans are expressed as CAP Guidelines, followed by the section number (e.g., CAP Guidelines, Section 1.1.2). All footnotes referencing sections of Proposed CAPSA Guideline No. 3—Guidelines for capital accumulation plans, May 2023, are expressed as Proposed CAP Guidelines, followed by the section number (e.g., Proposed CAP Guidelines, Section 1.1.2).

**1** CAP Guidelines, Section 1.1.2. **2** CAP Guidelines, Section 1.2. **3** CAP Guidelines, Section 2.1.1. **4** CAP Guidelines, Section 2.1.2. **5** CAP Guidelines, Sections 2.2.1 and 2.2.4. **6** CAP Guidelines, Sections 2.2.1 and 2.2.2. **7** CAP Guidelines, Section 6.3. **8** CAP Guidelines, Sections 3 and 4. **9** CAP Guidelines, Section 5.

## Investment selection and monitoring

Sponsors should provide a set of prudent and appropriate investment options to their plan members and should also outline a clear policy if members fail to make an investment election.<sup>5</sup> The options offered should be sufficiently robust to allow members with differing investor profiles to select a suitable portfolio for their long-term investment objectives. The funds selected must also comply with the investment rules under applicable CAP legislation.

The CAP Guidelines outline the process for fund selection, assessment of the different elements, and state the need to document the selection criteria.<sup>6</sup>

After sponsors select an investment lineup, they're required to monitor the selected funds to ensure that they remain suitable for their members and continue to meet their needs.<sup>7</sup>

## Onboarding and ongoing member education

Clear communication and active engagement with CAP members are vital to achieving successful member outcomes. Part of meeting this standard is ensuring that members receive materials and tools to support their onboarding and their ongoing information needs.<sup>8</sup> Documents supporting the onboarding process include:

- A plan summary and enrolment materials
- Investment options and decision-making tools to help members make an investment selection

On an ongoing basis, it includes:

- A regular member statement outlining plan holdings and investment performance
- Retirement planning tools
- A summary of any material plan changes or changes to the investment lineup
- Reporting and analysis of fund performance.<sup>9</sup>

## Fee management

A key element of the CAP Guidelines obligations revolves around fee levels and fee disclosures. Sponsors are required to ensure that fees paid by members in the program are reasonable and competitive. This applies to recordkeeping fees, fees for member advice, and investment fees.<sup>10</sup> Sponsors must also disclose all fees that are borne by members.<sup>11</sup>

## Investment advice

While optional, the sponsor may extend individual financial advisory services to members to help them plan for their retirement. If the employer elects to provide third-party advice,

it must select the advisor and ensure that the advisor is qualified to offer advice to members.<sup>12</sup>

## Maintaining a CAP

The obligations outlined in the CAP Guidelines mirror the principles developed in the common law for prudent practices in introducing and maintaining a CAP, including reviewing the CAP's service providers, investment options, records maintenance, and decision-making tools provided to members. The guidelines also cover the termination of a CAP or a member's participation in the CAP.<sup>13</sup>

# From 2004 to now—a changing landscape

To understand the context for the proposed updates to the CAP Guidelines, it's useful to look at the various ways in which the world of group retirement has changed in the last two decades since the original guidelines were adopted.

## 1 Growth of the CAP industry

Since the guidelines were first adopted, participation in CAPs has increased significantly, as have assets under management (AUM):

- Participation in registered pension plans has grown from just over 875,000 active members in 2004 to 1.2 million in 2022<sup>14</sup>
- AUM has almost tripled between 2007 and 2022, from \$45 billion to \$116 billion<sup>15</sup>

## 2 Investment options

The number of available investment options has also increased:

- In 2004, there were few target-date funds; today they represent a significant share of AUM, reaching 30% of all group segregated fund assets by March 2023<sup>16</sup>
- In 2009, the arrival of the tax-free savings account (TFSA) brought a new way to save

## 3 The rise of digital channels

Developments in digital technology since 2004 have changed the way sponsors and members can administer, manage, and interact with their retirement plans. Planning tools, transactions, educational resources, and reporting are all available online now. Mobile apps have made these features even more accessible. Email and text messaging have had an effect on the delivery of timely and relevant communications.

## 4 Access

The accessibility of group retirement plans has also changed, with the increased use of online enrolment, the availability of enrolment resources online, and the ability for sponsors to pre-enrol members by uploading a demographic file.

These developments have implications on virtually every aspect of the CAP Guidelines.

**10** CAP Guidelines, Section 2. **11** CAP Guidelines, Section 4. **12** CAP Guidelines, Section 3.4.1. **13** CAP Guidelines, Sections 6 and 7. **14** Statistics Canada, Table: 11-10-0106-01 (formerly CANSIM 280-0016). **15** Statistics Canada, Table: 11-10-0106-01 (formerly CANSIM 280-0016) modified to include assets of defined contribution plans. **16** Investor Economics - Group Retirement Savings and Pensions Report - Investment Product Shelf Update - Q1 2023.

# Overview of proposed changes and potential impact

Since 2022, CAPSA has been working on updated CAP Guidelines. The latest draft was released in June 2023 for feedback from various industry associations and firms, including the Canadian Life and Health Insurance Association (CLHIA), of which Manulife is a member.

The proposed changes focus on clarifying the responsibilities of parties within CAPs, enhancing member education and engagement, expanding on the disclosure requirements to members, elaborating the guidelines for governance, and anticipating the eventual arrival of new features.

## Highlights of proposed changes

The concept of “tangible benefit”	The draft guidelines introduce the new term “tangible benefit” used throughout the document where fees are mentioned. It’s defined as an outcome that’s actual, measurable, and/or which can be viewed as yielding or contributing to a positive outcome for members. <sup>17</sup>
Standard of care	The proposed guidelines formally acknowledge a standard of care owed by the sponsor to the members, which may in some instances include fiduciary responsibilities. <sup>18</sup>
Role and selection of service providers	Under the proposed guidelines, service providers must clearly indicate what tasks or functions they’re agreeing to perform. A service provider interacting with members must disclose to them whether it’s providing formal investment advice. The service provider must also inform the sponsor and members if it will benefit monetarily from a decision made by the sponsor or members. Finally, the sponsor is required to consider potential conflicts of interests, as well as the controls that are in place to secure members’ personal data when selecting service providers. <sup>19</sup>
Establishing a formal governance framework	The sponsor is required to establish and document a governance framework, which may include a description of roles and responsibilities; a communications process, a code of conduct, a risk management framework, a process to monitor service providers and investments; and a process for addressing member complaints. The precise scope and content of a governance framework may be adapted to account for the size and complexity of the CAP and CAP sponsor. <sup>20</sup>
Anticipating automatic features	The draft guidelines suggest CAP sponsors consider whether to set up automatic features, such as automatic enrolment, or escalation of member contributions, which may potentially lead to greater positive member outcomes. This section seeks to establish a framework for how they could be used and how they should be disclosed to members. <sup>21</sup>
Investment selection and monitoring	The factors that a sponsor should consider when choosing investment options, including any default option, have been updated. One notable addition is that the sponsor must consider whether the fees associated with investment options achieve a tangible benefit for members in terms of net return.  The new guidelines suggest that sponsors consider the increased governance burden, as well as the increased complexity that members face in their decision-making process, as the number of investment options in the plan grows. <sup>22</sup>

<sup>17</sup> Proposed CAP Guidelines, Section 1.2.8. <sup>18</sup> Proposed CAP Guidelines, Section 1.3.1. <sup>19</sup> Proposed CAP Guidelines, Sections 1.3.2 and 2.3.

<sup>20</sup> Proposed CAP Guidelines, Section 2.1.2. <sup>21</sup> Proposed CAP Guidelines, Section 2.1.3. <sup>22</sup> Proposed CAP Guidelines, Section 2.2.1.

<b>Member education</b>	<p>The proposed guidelines state that the sponsor should adopt a member education strategy that's designed to improve members' decision-making process and outcomes. They also suggest that sponsors should actively engage and encourage members to participate in the education process.<sup>23</sup> Finally, the proposed guidelines suggest that communications focus on sharing the projected value of member accounts and the impact of decisions on projected retirement benefits. Assumptions embedded in projection tools and decision-making tools should be disclosed to members.<sup>24</sup></p>
<b>Member statements</b>	<p>The proposed guidelines on member statements introduce several elements that sponsors should add to statements, including:</p> <ul style="list-style-type: none"> <li>• The member's personal rate of return</li> <li>• The total fee level and expenses paid by the member with respect to each elected investment option</li> <li>• A description or demonstration of the impact of fees and expected returns on the member's long-term savings and retirement income</li> <li>• A reminder of any plan features that the member isn't taking advantage of</li> <li>• Notice of any upcoming requirement or ability to commence retirement income</li> <li>• Minimum and maximum permitted withdrawal amounts</li> <li>• A summary of investment options listed by name</li> <li>• Disclosure of fees and expenses payable by the member (described further below)</li> </ul> <p>In addition, the member statement should be organized around "first page" content and, for a CAP with a retirement focus, the member statement should help them understand their level of savings and projected income in retirement.<sup>25</sup></p>
<b>Investment decision-making tools and advice</b>	<p>A new section addressing investment and financial planning advice was added to the proposed guidelines.<sup>26</sup> This section establishes that CAP sponsors should develop criteria to evaluate investment advisors and investment planners.</p> <p>Consistent with the approach outlined to evaluate all other service providers, the guidelines recommend evaluating conflicts of interest and the independence—or perceived lack thereof—of the advice provider relative to other service providers used in the CAP. Commissions and other incentives that the advisor receives from investments in certain options should also be evaluated when selecting advisors and planners for members. Finally, members should be told who is paying for the provided advice.</p>
<b>Disclosure of fees and expenses</b>	<p>The proposed guidelines introduce a new section focusing on fees and expenses.<sup>27</sup> The addition of a new fee section highlights the importance that CAPSA places on fee disclosures and communications to members related to fees. Fee disclosure should provide:</p> <ul style="list-style-type: none"> <li>• A breakdown of all fees, including transaction costs</li> <li>• The cost for any investment advice, investment fund fees, and investment fund operating costs</li> <li>• Any account, trustee, brokerage, custodial, and recordkeeping fees</li> <li>• Any fees for other services provided by service providers.</li> </ul> <p>Fees must be disclosed in plain language along with descriptions of what services are provided for those fees. Disclosures must also include a description of how those fees and expenses can affect members' balances, outcomes, and potential retirement income.</p> <p>Finally, the guidelines suggest that this information is to be presented in member statements.</p>

**23** Proposed CAP Guidelines, Section 3. **24** Proposed CAP Guidelines, Section 4.3. **25** Proposed CAP Guidelines, Section 5.1. **26** Proposed CAP Guidelines, Section 4.4. **27** Proposed CAP Guidelines, Section 3.4.

## Potential impact of proposed changes

The proposed revisions to the CAP Guidelines appear to be an acknowledgment of the need to modernize guidance to address the changes in the group retirement landscape. The draft covers new products, future innovations, a need for robust plan governance, more disclosures, and changes to the regulatory environment.

However, industry feedback, such as that offered by the CLHIA in its submission to CAPSA on August 3, 2023, has raised concerns about several aspects of the draft guidelines, particularly the *prescriptive* nature of the proposed guidelines compared with the original CAP Guidelines, which were *principles-based*.

The concern most expressed in the feedback is that the costs and administrative burden created by the prescriptive guidelines may deter some smaller and medium-sized employers from offering CAPs to their employees, or increase administration expenses for existing sponsors, which can have an impact on Canadians' ability to save for retirement.

Below are some of the comments from the CLHIA submission to CAPSA, and examples of the potential impact of prescriptive guidelines.<sup>28</sup>

<b>Member statements</b>	<p>The quantity of information that the proposed guidelines require to be provided on statements, including new disclosures, fees and expenses, and projections of retirement income, will require extensive customization and frequent modification of content.</p> <p>This is a concern, as the service providers who produce member statements often don't have access to the required information. Sponsors would need to create infrastructure to pass this information on to the service provider, which would be very difficult for small and medium-sized companies. Customizing statements to include these disclosures would therefore be extremely costly and could lead to higher costs for members.</p> <p>Furthermore, there are other methods than member statements for providing this information that will ensure that it's more readily available at key decision-making points. Digital channels, for example, could provide a more cost-effective and engaging way to distribute this information. The CLHIA therefore believes that it's important for sponsors to have flexibility around how they provide information to their members, whether in member statements or through other communication channels.</p>
<b>Fees and expenses</b>	The primary impact of the new guidelines is the need for clear disclosure of what members receive in exchange for any fees or expenses that they bear; however, current wording suggests fees need to be broken down to a degree that would result in disclosing information that's proprietary to each provider. Furthermore, to be of value to the member, the focus of the guidance should be a balance between the fees paid and the benefits or services those fees provide.
<b>Tangible benefit</b>	This definition implies something that's potentially focused on monetary benefit. Many activities that support good member outcomes aren't measurable in terms of a monetary benefit. The CLHIA recommends changing the definition to "value for plan members."
<b>Standard of care</b>	The language around the sponsor's standard of care and fiduciary responsibility to the member can be open to varying interpretations. The exact nature and extent of a CAP sponsor's responsibility depends on the specific circumstances.

<sup>28</sup> CLHIA Submission to CAPSA on Guideline No. 3 Consultation Paper, August 3, 2023.

<b>Service provider role</b>	<p>The requirement to inform members that the service provider isn't giving investment advice shouldn't apply in the many instances where advice is clearly not being provided, such as beneficiary changes and contact information updates.</p> <p>Regarding the requirement to disclose a possible monetary benefit from a decision the sponsor or members make, service providers are for-profit businesses that perform tasks and functions for a fee, and some of these require decisions from sponsors or members. As written, all of these would need to be reported to the sponsor.</p>
<b>Formal governance framework</b>	<p>Adding administrative burdens for non-pension CAPs may prevent smaller employers from offering a group retirement plan to their employees. A formal governance framework should be established where appropriate and shouldn't be a requirement for non-pension CAPs under the guidelines.</p>

## Establishing a CAP governance framework—getting a head start

While the final updated CAP Guidelines are only expected to be published in the later part of 2024 at the earliest, we assume that the requirement for a CAP governance framework will be a component of the guidelines.

By starting to think through what a governance system would look like for their CAP, sponsors can develop a robust framework and have it in place ahead of the implementation of the new guidelines.

### What is governance?

Governance is a formal structure and process that support rational decision-making.

An effective CAP governance system helps to ensure that all decisions are governed by clear criteria and considerations.

It also helps ensure that the same criteria and considerations are applied periodically to monitor those decisions over time and ensure that the decisions remain consistent and appropriate.

Finally, records of all decisions should be documented.

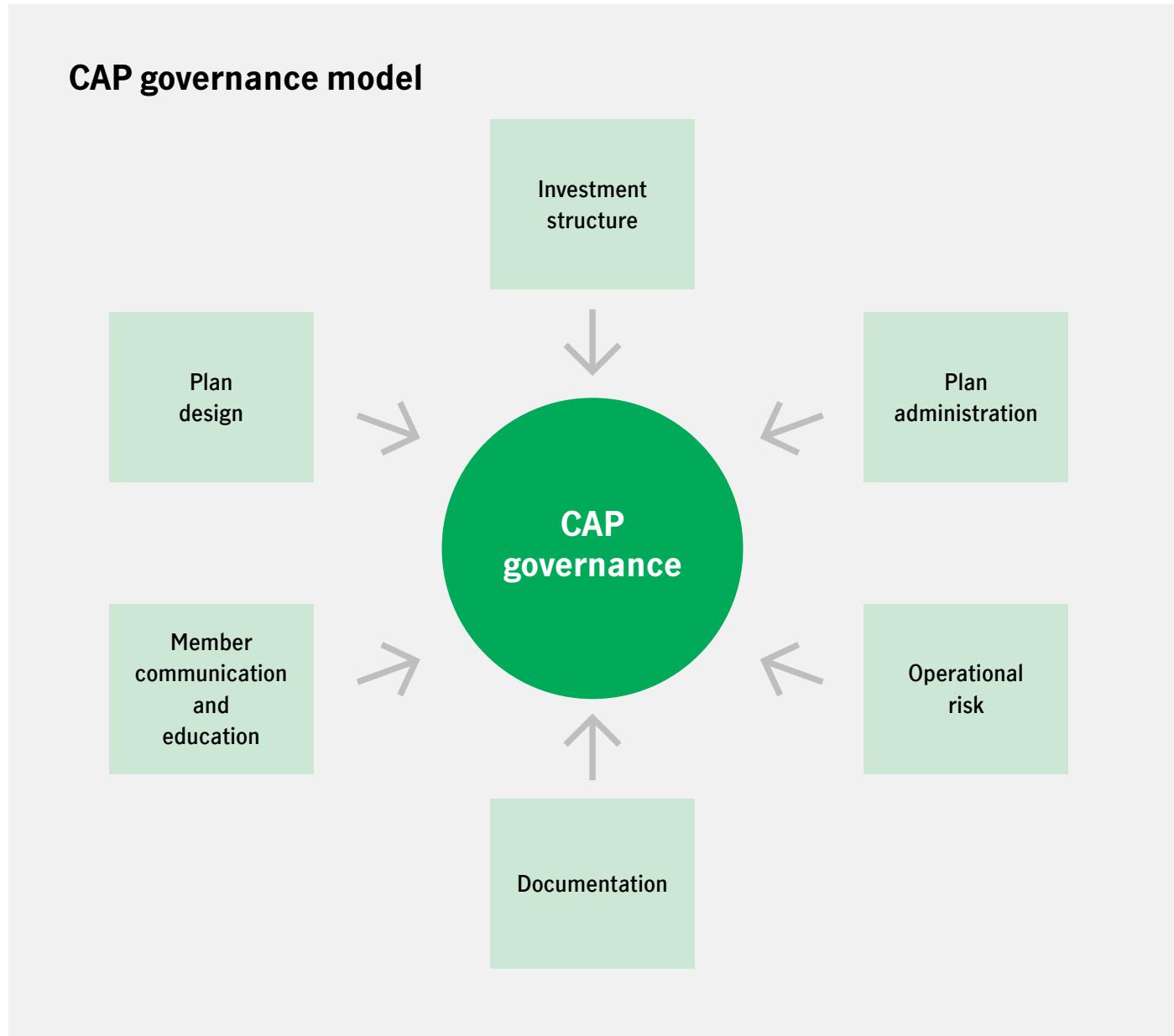
Due diligence may be the sponsor's most effective tool in helping to prevent situations that could lead to a legal challenge of CAP decisions. In the context of a CAP, this means:

- Generally following conventional practice
- Having a prudent decision-making framework that guides decisions and adhering to that framework
- Delegating to third-party experts where appropriate and overseeing their actions

## Who can help?

Advisors and consultants with CAP expertise can help sponsors in developing and maintaining a robust governance framework, helping them meet their CAP Guidelines obligations.

The table outlines the components and key elements of governance, as well as how advisors and consultants can help with each one.



# Helping sponsors to meet CAP Guidelines obligations

## Principles for CAP governance

Component of governance system	Key elements	How advisors and consultants can help
Plan design and implementation	<ul style="list-style-type: none"> <li>Identifying the optimal plan type</li> <li>Competitive contribution formula and plan terms</li> </ul>	Provide guidance on competitive plan features and contribution levels
Investment structure	<ul style="list-style-type: none"> <li>Establishing criteria for selecting and monitoring the investments offered</li> <li>Selecting the range of investments to be offered</li> <li>Fund selection</li> <li>Periodically monitoring the investment funds</li> <li>Ensuring reasonable fees</li> </ul>	<ul style="list-style-type: none"> <li>Assist the CAP sponsor in selecting and implementing a prudent investment structure for the plan</li> <li>Establish a preferred lineup that the sponsor maintains and monitors across its plans</li> <li>Assist in monitoring the appropriateness and effectiveness of the investment lineup over time</li> </ul>
Plan administration	<ul style="list-style-type: none"> <li>Establishing criteria for selecting and monitoring the recordkeeper</li> <li>Evaluating the capabilities of the recordkeeping</li> <li>Ensuring reasonable fees</li> </ul>	<ul style="list-style-type: none"> <li>Assist the sponsor in establishing reasonable criteria for selecting and monitoring the recordkeeper</li> <li>Assist in the selection process and periodic monitoring of the performance of the recordkeeper; the recordkeeper assessment should consider the ongoing competitiveness of the fee structure charged under the CAP</li> <li>Review recordkeeper reporting together with an annual compliance statement to assess the ongoing effectiveness of the recordkeeper</li> </ul>
Member education	<ul style="list-style-type: none"> <li>Design and rollout of enrollment material (including plan summary, risk tolerance questionnaire, retirement planning tools, description of investment options)</li> <li>Periodic review of plan communications</li> <li>Annual member education programs</li> <li>Annual member statements</li> </ul>	<ul style="list-style-type: none"> <li>Review the communication material supporting the CAP rollout and provide ongoing support</li> <li>Where the advisor is licenced, the advisor may wish to directly assist in the rollout of educational resources</li> <li>Periodically review the education material to ensure that it remains effective and relevant</li> </ul>
Documentation	<ul style="list-style-type: none"> <li>Drafting of plan text and other supporting plan documentation (e.g., the statement of investment policies and procedures)</li> <li>Periodic review of plan documentation to ensure it remains current</li> </ul>	<ul style="list-style-type: none"> <li>Engage the recordkeeper or external legal support to conduct an initial review CAP documentation</li> <li>Ensure that documentation is filed with the appropriate regulatory authorities</li> <li>Periodically encourage and assist in a review of CAP documents to ensure that they remain effective and in compliance with applicable legislation</li> </ul>
Managing operational risk	<ul style="list-style-type: none"> <li>Ensuring proper links with payroll</li> <li>Legal compliance of the plan</li> <li>Formalizing and documenting governance processes and key plan decisions</li> <li>Periodic review of plan documentation</li> </ul>	<ul style="list-style-type: none"> <li>Ensure that there's a prudent governance process in place that's documented by the CAP sponsor</li> <li>Ensure that the proper processes are implemented by the CAP sponsor and recordkeeper to maintain the plan</li> </ul>

# Final thoughts and next steps

CAPSA's objective of updating the CAP Guidelines to reflect changes in the marketplace and innovation in products has strong support from the industry; however, the task of updating the nearly 20-year-old guidelines is a complex one, as the feedback shows.

The chief concern expressed by industry organizations like the CLHIA is around the prescriptive nature of the proposed changes, which would create significant costs and administrative burdens for sponsors offering CAPs and discourage the adoption of new CAPs. The CLHIA supports a further revision of the CAP Guidelines to bring them back to a principles-based approach, which could help sponsors implement these changes and comply with new guidance in a cost-effective manner.

## Next steps

In a joint letter to CAPSA dated August 4, 2023, the CLHIA, the Association of Canadian Pension Management (ACPM), and the Pension Investment Association of Canada (PIAC) requested that CAPSA reconvene its industry working group to review the draft guideline in detail.<sup>29</sup>

CAPSA confirmed that the industry working group will reconvene in 2024, which could potentially lead to a new draft of the revised CAP Guidelines.

<sup>29</sup> "CAPSA's draft CAP guideline alters industry standards, say ACPM, CLHIA, PIAC," Benefits Canada, August 10, 2023.



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