April 16, 2010

The Honourable Marilyn More
Minister of Labour and Workforce Development
Pensions Review – Policy, Planning and Professional Services Branch
Nova Scotia Labour and Workforce Development
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Dear Minister:


The Investment Funds Institute of Canada (IFIC)\(^1\) welcomes the opportunity to follow up on our November 13, 2008 response to the Nova Scotia Pension Review Panel by participating in consultations with respect to the Department of Labour and Workforce Development’s “Discussion Paper on Pensions” (discussion paper). IFIC members provide services to Canadians across the country; nearly 7,000 advisors and other staff in Nova Scotia are assisting their clients in the province to save and invest well over their working lives, to help generate the income to enable their clients to retire with the peace of mind that they will not outlive their savings.

We are pleased that one of the first goals of the proposed pension legislative framework is “… to do no harm to … existing plans,” and that the Nova Scotia government is participating with federal, provincial and territorial counterparts, to whom we are also writing, to examine pension coverage and retirement income adequacy of Canadians.

While considerable independent analysis suggests there is not a general retirement income crisis in Canada, we think improvements can be made and that now is the time to look for new ways to prepare for the future given our aging population. The first and second Pillars of Canada’s retirement income system – Old Age Security/Guaranteed Income Supplement/provincial income supports and the Canada/Quebec Pension Plan – are reviewed regularly. The defined

\(^1\) IFIC is the national association of the investment funds industry. Its members are mutual fund companies, retail distributors and industry affiliates. Mutual funds enable Canadians to (i) invest in capital markets while diversifying (reducing) risk, (ii) have their savings managed professionally and (iii) obtain expert financial advice to help them plan for and cope with important events in their lives (like having a baby, buying a home, being laid off, managing an elderly parent's financial affairs or receiving an inheritance). There are virtually no dollar barriers to starting a mutual fund account. Indeed, some of our members offer savings programs for as little as $25/month.
benefit and defined contribution plans of the third Pillar have been examined recently in great detail, including by the Pension Review Panel.

In addition to providing comments on retirement savings issued generally, our submission addresses two of the Pension Review Panel’s recommendations in specific:

- **Recommendation #6 – “Safe harbour” provisions:** We agree with the Department of Labour and Workforce Development that there should be reasonable protections for plan administrators and committee members.

- **Recommendation #30 – Creation and administration of a province-wide pension plan:** Most Canadian and international research reports come out clearly in favour of the Canadian system as it is and particularly of its balance between Pillars. We have not seen an assessment suggesting that an expansion in the second Pillar will address the Pension Review Panel’s stated areas of concern. In addition, we are not aware of an analysis of the economic impact of a shift from private to public sector retirement savings plans on investors, taxpayers, businesses, the self-employed, capital markets and the economy generally, nor an estimate of the potential costs of such a shift.

We believe we can improve retirement savings overall by improving the way most Canadians in the private-sector save, namely, through individual and/or group RRSPs and non-registered investments. The third Pillar is critical as it is the only Pillar through which financial advice is provided and the vast majority of people need at least some financial advice. For middle-income earners in the private sector, advice is critical, especially due to the growing number and complexity of government tax-assisted savings plans, variation in tax treatment of plans under federal and provincial pension and tax legislation, and the major financial events that Canadians will experience at some point in their lives. Our specific recommendations to the Nova Scotia government, as well as to its federal and provincial counterparts, are:

1. Make it easier and more appealing for employers (particularly small- and medium-sized businesses) to establish retirement plans affordably, including by providing appropriate protection from liability to employer plan sponsors acting in good faith

2. Increase the number of Canadians that participate and save enough in employer or individual retirement savings plans through the introduction of automatic enrollment and contribution escalation features, and better financial education

3. Ensure tax-benefit parity between all Canadians, whether they are in the private or public sector or in DB, DC, group RRSP, RRSP or other tax-advantaged plans, both before and in retirement, for example, by increasing deductible contribution limits to meet the federal public service plan benchmark of 34% of earned income

4. Understand and support the value and significant advantages of Canadians’ access to financial advice when comparing all-in costs and benefits of features available within government-provided, employer-sponsored and individual retirement plans and other savings vehicles.
We elaborate on these four recommendations in Appendix 1, building on our December 15, 2009 submission to you entitled “Improving Retirement Income in Canada”. In Appendix 2, we address the recommendation regarding the creation and administration of a province-wide pension plan in more depth.

We would be pleased to provide further information or answer any questions you or your officials may have – please contact me directly or Barb Amsden, Director, Strategy & Research at bamsden@ific.ca or (416) 309-2323.

Yours sincerely,
IMPROVING RETIREMENT INCOME SAVINGS

There has been considerable focus on retirement savings over the past year and many studies have been commissioned. The result of this significant analysis strongly suggests that Canada is not suffering from a general retirement income crisis. There are improvements that can be made and, given our aging population, it would be worthwhile to look for new ways to prepare our system for the future.

Some options under consideration in provincial government discussion papers and elsewhere are evolutionary in nature, while others involve quantum changes. The former are the result of extensive consultation and detailed background review, and there is general agreement on solutions. The changes that represent a paradigm shift, such as a broad CPP expansion or a CPP-based supplementary plan, do not include an analysis concluding that a shift between the Pillars would address concerns. Indeed, domestic and international research reports come out clearly in favour of Canada’s retirement income system with its balance between Pillars. If there is reason to examine a shift between Pillars, Canadian savers and taxpayers should be shown the estimated costs, benefits and risks of the CPP and other government-sponsored supplementary DC plan alternatives on investors, taxpayers, businesses, the self-employed, capital markets and the economy generally.

We think there are more targeted, sure, cost-effective ways to remove complexity, uncertainty and regulatory costs and promote significantly increased retirement savings. Falling into four themes, they are as follows:

1. Make it easier and more appealing for employers (particularly small- and medium-sized businesses) to establish retirement plans affordably, including by providing appropriate protection from liability to employer plan sponsors acting in good faith

Improving employer-sponsored RRSPs is an effective, low-cost, practical solution that would immediately benefit the millions of Canadian employees that already have these efficient savings plans and the millions more who could be offered these plans after the improvements are made. It would also leverage the existing relationships and specialized services offered by professional financial advisors to owners of small businesses.

If efforts are undertaken to slow the decline in DB plans, then efforts should equally be taken to make more “pension-like” those aspects of registered retirement savings plans that may

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make them less satisfactory in the eyes of pension supporters. These aspects include uncertain investor returns, ability to withdraw and cost. Below are our recommendations to address these issues.

**a. Encourage the federal government to expand the Income Tax Act (ITA) rules relating to locked-in RRSPs to limit the ability to withdraw from RRSPs by allowing or requiring locking-in of employer contributions:** While a benefit of RRSPs in emergency situations is the flexibility to withdraw funds, this can also lead to the undesirable depletion of savings. The ease with which Canadians can withdraw their retirement savings from their RRSPs is cited by both employers and policy-makers as a drawback of this plan type and there are now tax-free savings accounts (TFSAs) for precautionary savings.

To the extent that the preference for defined contribution (DC) plans over RRSPs arises due to their limits on unlocking – indeed the 2009 Melbourne Mercer Global Pension Index suggests that introducing a mechanism for ensuring that voluntary retirement savings are preserved for retirement purposes is a way to improve the Canadian retirement income system – governments could agree to allow or require locking-in for at least employer-offered RRSPs and TFSAs, with certain permitted withdrawals and re-contributions (e.g., home buyers plan, lifelong learning plan, registered education savings plan (RESP), etc.). However, under the current rules, only an individual moving to new employment can transfer funds from a registered pension plan to a locked-in RRSP or locked-in retirement account (LIRA). We recommend allowing at least employers to lock in their contributions in group RRSPs on the employees’ behalf.

**b. Reduce unnecessary business costs of offering plans:**

i. **Encourage the federal government to allow employers to contribute directly to group RRSPs for their employees:** This means that – as for DB and DC pension contributions – CPP, employment insurance (EI) and other payroll taxes will not apply. By removing the payroll tax burden, employers will be incented rather than penalized when they make these contributions.

ii. **Broaden access to multi-employer plans by allowing regulated financial institutions to offer such plans and publicizing their existence:** This involves eliminating current requirements for an employment relationship between the sponsoring institution and plan members, and allowing any employer (and the self-employed) to participate in professionally managed plans that in time would provide economies of scale as the number of plan participants and assets grew. In Canada, there are growing numbers of such plans, but they are often little known.

iii. **Simplify and harmonize regulatory and administrative requirements governing retirement savings plans and investments across Canada, and provide appropriate protections (safe harbours) for firms sponsoring plans in good faith:** The January 2010 report of the Steering Committee of Provincial/Territorial Ministers on Pension Coverage and Retirement Income Adequacy entitled “Options for Increasing Pension Coverage among Private Sector Workers in Canada” (Steering Committee report)
recognizes that “… rising costs and mounting risks, along with increasing regulatory burden, are making employer sponsorship of [DB and DC] pension plans far less attractive”. The rules governing RRSPs are national in scope, which we believe makes the RRSP an ideal savings plan type on which to continue building a national solution. Group RRSPs are simpler to set up and generally entail a lower regulatory burden than registered pension plans. They therefore are more attractive for smaller and medium-sized businesses than DB or DC plans. We believe that a national framework such as is offered by GRRSPs would reduce complexity, increase transparency and lower regulatory costs faced by plan sponsors and/or plan participants.

Provincial pension studies also highlight the importance placed on providing ‘safe harbours’ for sponsors that offer pension or retirement savings options. Providing retirement savings options is not the business that most businesses are in, so we believe employers should be provided with an appropriate level of protection from undue liability (for example, with respect to options made available to employees and the performance of employee-selected investments), provided these firms comply with certain straightforward agreed-upon minimum due diligence guidelines.

c. **Encourage employers to offer retirement savings plans:** As firms are more tax-sensitive than individuals, we recommend that a small tax incentive be provided to employers to encourage them to offer a retirement savings plan with auto-enrollment of employees and auto-escalation of contribution features. This should have a large effect on the savings rates and retirement outcomes of Canadians with little impact on government expenditures.

2. **Increase the number of Canadians that participate and save enough in employer or individual retirement savings plans through the introduction of automatic enrollment and contribution escalation features, and better financial education**

The number of Canadians participating in retirement savings plans and the threshold of contributions can be improved by certain techniques that preserve choice, but make it easier for the saver/investor to avoid missing out on retirement savings opportunities due to the lack of time, expertise or interest. As noted above, one method is the ability of employers to lock in contributions to GRRSPs. Others are as follows:

a. **Promote auto-enrollment of employees and auto-contribution escalation of employee contributions into employer-offered plans:** The federal and provincial governments jointly should make the changes necessary to allow for automatic enrollment of employees and automatic escalation in contribution rates as, say, salary or length of service increases, with the ability to opt out, to enhance both participation and savings rates. This would require provinces that prevent automatic pension enrolment and payroll deduction of contributions and contribution escalation to exempt these features from the explicit consent requirement.

Research suggests automatic enrollment even with an opt-out at the investor’s choice will substantially increase savings with no loss of choice or flexibility. The adoption of automatic enrollment in 401(k)s resulted in employee participation rates rising often to
above 90%, especially among lower-income and minority workers, who had frequently been disadvantaged in the past. However, how auto-enrollment and opt-out is to work should be studied to ensure the minimum of administration for employers and employees.

b. **For individuals without access to employer-sponsored retirement plans, consider whether there could still be mandatory auto-enrollment into the savings vehicle of the individual’s choice, with the right to opt out:** This will allow the benefits of auto-enrollment to accrue to individuals working for firms without retirement savings plans.

c. **Encourage the federal government to correct the unfair application of the Goods and Services Tax (GST) and harmonized sales tax (HST), which apply more heavily to mutual, segregated and other funds than non-fund investment products offered by the private sector, by applying a single low federal-provincial rate of sales tax to management, advisory and administrative services provided to funds.** For the past 19 years, the GST has applied at effective rates of four to five times as much on mutual and other investment fund products as on non-fund financial products. Ontario’s and B.C.’s sales tax harmonization announcements, which are extending sales tax harmonization to mutual fund investors in Nova Scotia, New Brunswick and Newfoundland for the first time due to changes in how the HST will apply, combined with Nova Scotia’s recent sales tax rate increase, will exacerbate the long-standing unequal treatment of fund-holders under the GST. This is not because of the higher “value-added” in a mutual fund, where additional taxation would be expected, but because the labour/salaries and net earnings that are part of delivering a mutual fund are fully taxable, but tax-exempt in the case of holdings of GICs, equity and debt.

A further inequity is that there is little to no sales tax paid with respect to government pension plans, while DB and DC pension plans receive a 33% GST/HST rebate and those saving in RRSPs pay the GST or HST without relief. Middle-income-earners and seniors bear the brunt of this tax inequity. Approximately 77% of Canadian mutual fund-holders hold mutual funds in registered plans such as RRSPs and RRIFs (Ipsos-Reid, April 2009). According to Pollara, an estimated 73% of mutual fund owners are near-retirees (45-64) and retirees (65+). Over a third of middle-income households – those with incomes of $70,000–$100,000 – hold mutual funds (Ipsos-Reid, 2009).

d. **Encourage the federal government to adjust the dividend gross-up in the means-tested “net income” calculation for Old Age Security (OAS) and Guaranteed Income Supplement (GIS) benefits:** Some seniors try to avoid dividend income because of the dividend gross-up, meaning that seniors with the same income may have different net income for purposes of social benefits calculations and hence receive substantially and unfairly varying net benefits. The dividend gross-up from the “net income” calculation should be eliminated for purposes of computing OAS and GIS income-tested benefits so the claw-back includes actual dividends received, not the grossed-up amount of 125% for ineligible dividends or 145% for eligible dividends.
e. **Promote the hosting by employers of financial education sessions by pension or GRRSP plan sponsors to provide employees with basic planning tools:** Research suggests that offering education at the time of employment significantly boosts financial literacy and may positively affect the number of employees who participate in plans and amounts saved.

f. **Implement legislative changes to provide creditor protection to non-insurance RRSPs:**
   This will ensure consistency across the country of protections in a bankruptcy between mutual-fund-based RRSPs and DB/DC plans.

3. **Encourage the federal government to ensure tax-benefit parity between all Canadians, whether they are in the private or public sector or in DB, DC, group RRSP, RRSP or other tax-advantaged plans, both before and in retirement, for example, by increasing deductible contribution limits to meet the federal public service plan benchmark of 34% of earned income**

Over time, Canadians have become more mobile and the expectation of having one or two jobs in one’s career in a single city has gone from being the norm to the exception. Even those who stay with a single company for a while may choose not to join a pension plan if offered due to its locked-in nature. The Canadian retirement income system should recognize changes in demographics and the nature of work, and seek to provide equivalent benefits to the extent possible given the wide variation in retirement savings scenarios a Canadian may experience – DB or DC plan or group RRSP, RRSP, TFSA or other. Specific recommendations with respect to changes to the *Income Tax Act* to extend pension-related tax benefits to RRSP-holders include:

a. Amend the ITA to extend the minimum income-splitting age with a spouse or partner from 65 to 55 for RRSPs, consistent with rules governing pension plans

b. Reduce registered retirement income fund minimum withdrawal factors and increase eligible DB-to-RRSP transfer limits in Income Tax Regulation 7308 to reflect an older population, longer life spans and today’s lower interest rate environment

c. Eliminate the double taxation of dividends in registered plans

d. Make the pension credit available to people receiving income from a registered retirement income fund (RRIF) or life income fund (LIF) regardless of age, as it is to recipients of annuities from pension plans

e. Allow those who leave the workforce for specified reasons (e.g., childcare, job loss) to accumulate RRSP room; permit those who are self-employed and may have widely varying incomes from year to year to base RRSP contributions on average income allowing the carry-forward or back of earned income above the annual limit to maximize RRSP deductions; and consider relief for those who may have faced or face substantial market losses, from which most members of DB plans were shielded, to be able to deduct some losses from ordinary income
f. Raise the RRSP contribution limit from 18% to 34% of earned income and maximum dollar amount proportionally to meet the federal public service plan benchmark³.

4. Understand and support the value and significant advantages of Canadians’ access to financial advice when comparing all-in costs and benefits of features available within government-provided, employer-sponsored and individual retirement and other savings vehicles

In some of the analysis that is done comparing private and public-sector retirement savings options, advice is often undervalued. The vast majority of people need at least some financial advice. For middle-income earners in the private sector, advice is critical, especially due to the growing number and complexity of government tax-assisted savings plans, variation in treatment under federal and provincial pension and tax legislation, and the major financial events that Canadians will experience at some point in their lives.

A 2009 survey by Canadian securities regulators confirmed the value Canadians place on the professional advice that helps them stay on track to reach their financial goals. It also showed some surprising other benefits that people get from their advisor:

- 72% of respondents cited their financial advisor as the most important source of information to teach their children about personal finances or investing
- ‘Do-it-yourself’ investors are more likely to be approached with and become victims of fraud.

Advisors provide advice to Canadians with respect to assets from which the advisors derive no financial benefit, the most frequent types being payments from the CPP and employer DB and DC plans. Additionally, as Don Stewart, Chair of the Task Force on Financial Literacy, noted:

> “The growth of information, regulation, technology and products will outpace our ability to remain current. Advice makes information understandable and usable; advisors ensure follow-through, bridging the disconnect between knowledge and action.” (November 26, 2009).

Financial advice is helpful at every critical life stage. Advisors have been described as “nags”, but by pushing for more savings, Canadians end up with more savings. An Australian IFSA/KPMG study, “Value Proposition of Financial Advisory Networks” (October 29, 2009), showed that investors who use an advisor have higher savings and make more contributions than those without one. This is due to a range of reasons, including advisors set targets, help avoid common behavioural mistakes such as trading too much, push for regular contributions and so on.

Advice is even more important for those Canadians near or at retirement. It is hard to contemplate transition to and life in the post-retirement period without at least some form of

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³ Bill Robson, C.D. Howe Institute, February 2010, Cutting Through Pension Complexity: Easy Steps Forward for the 2010 Federal Budget
counsel to help individuals decide when to start taking CPP, what the most tax-efficient investment and decumulation decisions are, how to manage investments as interest rates start to rise and so on. These are complex areas, touching all aspects of Canadians’ lives and requiring customized – not a universal one-size-fits-all – solution. The value of advice must be recognized and our recommendations in this regard are:

**a. Build in age-appropriate financial literacy principles to school curricula:** The first “advice” Canadians would benefit from is an introduction to and reinforcement in the value of saving and investing over a lifetime. Efforts in this regard are being undertaken by governments in a number of provinces, most notably Manitoba, and we believe will help contribute to a discerning population able to make decisions on financial matters throughout their lives or to seek effectively the assistance of a qualified advisor to help them. We encourage Nova Scotia to do the same.

**b. Ensure that research cited in government policy reviews on the subject of the costs and value of investment management and advice has been tested for robustness and include appropriate caveats:** A fundamental principle of analysis is ensuring comparability of data through obtaining data that meets common definitions, or is adjusted using reasonable assumptions to correct for any differences. Alternatively, data weaknesses should be noted clearly. Specifically, DB and DC plans and retail mutual funds seem to be being compared without a clear explanation of what is behind their difference in cost.

- Defined benefit costs may appear low, however, they are essentially for one big investment fund with money coming in and leaving on a known basis and almost no user services.
- Defined contribution plan costs vary depending on the collection of funds, services provided, size of plan, etc., but the inflows are largely predictable and therefore more easily manageable.
- Retail mutual funds have higher costs as they bundle more comprehensive services, have no certainty in deposit or withdrawal timing, the service is personalized and the advice provided deals with well more than retirement issues, for example, managing education savings, job loss, inheritance and the identification of tax efficiencies.

In addition to incomplete comparisons of savings and investment products domestically, cost comparisons between countries frequently compare apples and oranges.

Of concern to us is that a number of the studies relied on in the Steering Committee Report contain results that we have not been able to replicate and/or data or methodology weaknesses. We believe that a reference should be added to the Ministers’ Steering Committee report to recognize this so that the references in the paper do not become

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Minister Marilyn More
Re: Expanding Retirement Income Adequacy in Canada
April 15, 2010

relied upon without verification by future users as the basis for pension and retirement savings policy development.
MINISTER MARILYN MORE
Re: Expanding Retirement Income Adequacy in Canada
April 15, 2010

APPENDIX 2

COMMENTS ON RECOMMENDATION # 30
CREATION AND ADMINISTRATION OF A PROVINCE-WIDE PENSION PLAN

The majority of points in recommendation # 30 deal specifically with a province-wide government-sponsored plan, which we address below along with options being discussed among the federal and provincial governments, such as an expanded CPP or a supplemental DC component to the CPP. Within recommendation # 30, a number of more general problems are raised that should be addressed, including “orphan” accumulations disbursed by plans being wound down. As well, we believe the suggestion of plans for employer clusters is valid and support broadened access to multi-employer plans by allowing regulated financial institutions to offer such plans and publicizing their existence.

With respect to an increased government involvement in retirement savings through a province-wide or national plan, there are three pivotal questions to examine:

First, does the evidence suggest that a new or incremental government-sponsored pension plan is warranted? The research that made up the Mintz and Baldwin reports did not come to this conclusion, although the Baldwin report raised the appropriate level of government involvement. The Whitehouse OECD-based analysis suggests that the current balance has led to a very low level of senior poverty in Canada. Rather than changing a diversified system that has proven to have worked well without evidence of an immediate need for major changes, we believe that it makes sense to take the time to identify ways to improve on the system without a significant change with as-yet-unquantified costs and risks.

Second, if a change from private to government-sponsored or -managed plans is being contemplated, has transparent analysis and discussion of the estimated costs, risks and other impacts of the government-based alternatives taken place and been compared to other alternatives? The answer is ‘not to our knowledge’. Points to examine include the following, with possible conclusions based on what we do know shown beside each:

- Implications for business: If such a plan were to be funded by an increased levy on employers, there could be a disincentive to expand employment and a possible incentive to reduce jobs. It is unlikely that businesses would easily be able to reduce significantly or eliminate wage increases to offset the businesses’ increased mandatory costs, at least in the immediate term.

- Implications for the self-employed: The impact on the self-employed could be negative if the plan were mandatory to the extent that the private savings that potentially would be crowded out is investment in self-employed Canadians’ own business(es).

- Implications for capital markets: On the positive side, if assets moved from a voluntary savings channel to a forced savings channel, asset managers could reduce their average cash balances thus potentially increasing aggregate investment, including in more illiquid longer-term and possibly higher-return assets. On the negative side, concentrating more assets in the public sector in the hands of one entity, even if it outsources management to several
managers, would potentially increase systemic risk and decrease competition, which could impact overall market efficiency.

- **Economic implications of current consumption:** If there were a forced savings aspect of a proposal, there would be implications for current consumption. To the extent that this discourages ‘wasteful’ consumption and improves retirement outcomes, it might be positive; however, at lower levels of income it may reduce welfare over a lifetime.

- **Implications for other savings plans:** There would likely be a shift between plan types. Using the CPP options referenced in the Steering Committee’s report as a model, as much as 43% of RRSP/RPP contributions would be crowded out at the $50,000 to $60,000 total income level and as much as 39% at the $100,000 to $150,000 income level. Also, without exclusions for Canadians with lower levels of income, it would worsen these Canadians’ net after-tax income as it would likely be better for them to save in a TFSA rather than be forced to save through a supplemental CPP tranche. The Canadian Institute of Actuaries (CIA) notes the risk that “… in fact all of the plans reviewed, create the possibility that many existing and superior private plans may be closed and replaced with less advantageous schemes.” (“White Paper: Government-Facilitated Retirement Income Plans”, March 2010).

- **Implications for other government spending:** While this would not be expected to have an effect on government spending barring liability issues referenced below, the Ministers’ Steering Committee report notes that both CPP models may lead to “… pressure to increase other taxes or lower program expenditures to adjust for the deferral in tax revenues, although this could be mitigated over time.”

- **Implications for the fund/asset management industry:** There will be negative effects on aggregate jobs in the industry, with some transfer but mainly a reduction in jobs among asset managers, financial advisors and people employed in transfer agency, accounting, legal, sales and marketing departments as businesses refocus on the institutional rather than the retail side. There also could be related multiplier effects on the broader economy.

*Third, what are the potential implementation, transition and ongoing costs of such a shift and are they outweighed by the benefits?* As of yet, we have not seen an estimate of the projected costs of implementation, transition and ongoing administration of such a system. One major cost to consider is the implicit government liability that would arise if a DC-based government-sponsored system did not deliver the retirement expected, for example, due to the downturn recently experienced. Even if a government takes every step possible to limit its legal liability, a number of experts question whether it is possible to avoid political accountability. The Steering Committee’s report recognizes the costs of setting up provincial plans (particularly on a voluntary basis in a country with as relatively small a population as Canada) and considers the CPP as a plan capable of providing the economies of scale – this would shift but not eliminate political liability.