

Proceedings of the Standing Senate Committee on Banking, Trade and Commerce

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OTTAWA, Wednesday, May 30, 2012

The Standing Senate Committee on Banking, Trade and Commerce met this day at 4:17 p.m. to examine the subject matter of those elements contained in Divisions 2, 10, 11, 22, 28 and 36 of Part 4 of Bill C-38, An Act to implement certain provisions of the budget tabled in the House of Commons on March 29, 2012 and other measures.

Senator Irving Gerstein (*Chair*) in the chair.

[*English*]

The Chair: Honourable senators, this afternoon we continue our pre-study of certain divisions of Part 4 of Bill C-38, the jobs, growth, and long-term prosperity bill.

We have already heard from the Minister of Finance and officials from the Departments of Finance, Industry and Human Resources and Skills Development.

We have also heard from two agencies impacted by the legislation: Canada Mortgage and Housing Corporation and the Office of the Superintendent of Financial Institutions.

We will now continue our work hearing from those outside of government. In the first hour, we welcome two professors. Here with us in Ottawa is Ian Lee, Assistant Professor with the Sprott School of Business at Carleton University. Joining us by video conference from Guelph is Jane Londerville, Associate Professor in the Department of Marketing and Consumer Studies at the University of Guelph. The professors are here to discuss Division 11, which deals with the governance of the Canada Mortgage and Housing Corporation.

We have one hour for this session. Professor Lee, we will hear from you first.

I assume, Professor Londerville, you can hear us in Guelph quite clearly.

Jane Londerville, Associate Professor, Department of Marketing and Consumer Studies, University of Guelph, as an individual: Yes, I can hear you fine.

The Chair: After that, we will have time for questions.

Ian Lee, Assistant Professor, Sprott School of Business, Carleton University, as an individual: Thank you very much, Senator Gerstein and honourable senators. It is an honour and a privilege to appear before what I believe is the oldest continuously operating committee of the Senate, dating back to the very origins of our country in 1867. In fact, I feel the ghosts or spirits of history past in this room, not only because of the history of this committee, but because I know of or have had the pleasure to meet some of the members of this committee in the past. Although I have no consulting contracts with any organization anywhere — private, public, non-profit, union — nor do I hold any investments of any kind, as I am merely a poor professor, I must disclose that while I am not a member of any political party today, I did run in the 1993 federal general election against then Liberal member of Parliament and now Senator Mac Harb. He won decisively and conclusively. There were no recalls or recounts.

The Chair: We will note that you made that disclosure prior to the time that Senator Harb did.

Mr. Lee: I wanted to beat him to the punch. Parenthetically, and I will come back to these issues, I did run at that time on positions exclusively focused on fiscal prudence, fiscal probity, and what is generally called fiscal conservatism. I do not speak about or address social policy or social issues at all. I will return to those issues.

To finish off on this preamble, in 1991, I completed my very first television interview, with the most remarkable journalist in the history of our country, the late Barbara Frum, whose daughter I believe sits on this committee.

I cannot let pass that I have been extraordinarily fortunate to have met Senator Marjory LeBreton on several occasions. She is one the most distinguished and honourable Canadians that I have ever known.

Finally, although he is not a member of this committee, I have been privileged to debate Senator George Baker on Global TV's *The West Block* over the past several months. While I have been told I do not suffer from a lack of self-esteem, I can state that Senator Baker is one the most formidable and intimidating debaters I have ever known, who gives me the willies.

If I may quote from our debate last Sunday, Canada and, for that matter, every Western country is at a unique moment in history. For the first time in 2,000 years, world leadership is shifting from the West to the East. From the time of ancient Greece and the Roman Empire to the British Empire, the home of my late father, and then the American empire, Westerners or Occidentals have understood that the West ruled the world. No more. This is and will change

everything. That will lead to the second transformation as we in the West, as Governor Carney and others have noted, have been living beyond our means for the past 40 years and the bills are now coming due.

The third transformative event is the aging of the boomers, my generation, who I believe caused much of the second problem of living beyond our means. Sadly, there are countries in southern Europe and the United States that do not know that they do not know that these changes are happening and that we must all change our policies in every sector from top to bottom.

Budget 2012 is, in my view, profoundly important for it represents the beginning of the undoing and the redoing of policies in sector after sector that are absolutely essential to deal with these three world historical changes — the shift from East to West, the aging of the baby boomers, and the fact that we have lived beyond our means for 30 or 40 years, and not just in Canada but in all the OECD countries.

Now let us turn to housing policies and CMHC. Just as a preamble, in the 1970s I was the mortgage manager of a quarter of a billion dollar portfolio, the fourth largest branch the Bank of Montreal, about 100 feet from here, except that it was taken over by the Government of Canada. I worked in that branch for many years throughout the 1970s and early 1980s, lending millions of dollars of mortgages. I dealt with CMHC on the ground, as it were. I realize that was 30 or 40 years ago but mortgage lending has not changed fundamentally in the sense that you are evaluating risk, and trying to adjudicate risk and minimizing risk. The particular policies of whether we require 20 per cent or 25 per cent down payment, as it was when I was a mortgage manager, or whether we do 30 years or 40 years, are details, important details, but they do not change the fundamental issues that are being dealt with in housing and in mortgage lending.

Very quickly, CMHC was established, as we know, in 1946 to help with housing for returning soldiers, which was a laudable objective. To use somewhat more theoretical language, that is what is called a market failure because the markets could not do that at the time, so government stepped in.

Over the past 50 or 60 years, like Topsy, CMHC grew and grew and grew. It is in at least five lines of business, as I can determine. First, it is in commercial mortgage insurance for high ratio mortgages. Second, it is engaged in social housing. Third, it is engaged in economic and statistical analysis, and there is an army of excellent economists and statisticians within CMHC. Fourth, they have the green and energy conservation initiatives and programs. Fifth, they act as a market maker as a bundler and reseller of mortgage-backed securities intervening in capital markets with the securities.

The problems, as I see it, I have said in op-eds and in interviews. I should disclose that I completed two papers three years ago at the time of the housing and financial crisis in 2008-09. I argued at the time that I completely disagreed with the conventional wisdom that it was caused by banks in New York City. I argued it was caused by the failure of the United States Congress to properly regulate housing. In fact, they watered down and undermined the mortgage credit underwriting standards. I can say that as someone who actually worked in a bank, who lent money in a bank to people for housing. I know what they were doing in the United States because I investigated it and I know people in American banking.

They had some profound problems. Those are what triggered the problem. We were fortunate for many reasons, including good policy, that we did not suffer the same collapse that they suffered and they are still living with one third of all houses underwater today.

Nonetheless, I have argued for a long time that CMHC has a governance problem. It operates in secrecy. We do not even know what they are doing completely in terms of the risk, in terms of the tranches, what the delinquency ratio is on mortgages with one set of down payment versus another.

The second point is that it is the only mortgage insurance company in Canada that is not regulated. As someone who believes strongly that banks and financial institutions, including near banks, must be regulated, my views are very similar to Governor Carney. We must regulate them. It is beyond imagination that CMHC has been unregulated. I do not consider regulating myself as a form of regulation. We all do that. We all regulate ourselves but we still have police, courts and so forth, and they are not.

Third, more fundamentally, I did testify three years ago before the House of Commons Finance Committee, with the CMHC CEO and vice-president sitting beside me, and I do not think they were too happy when I said that I think CMHC does not possess a strategic understanding of its own business.

I realize that seems very strong. However, I remind you that in August 2006 on the front page of *The Globe and Mail*, on the top of the fold, was a story of then Governor David Dodge going down to CMHC headquarters on Montreal Road and charging into the CEO's office. This was shortly after they introduced 40-year amortization, zero down-payment mortgages, which I characterized at the time as an attempt to emulate the failed Fannie Mae and Freddie Mac in the United States.

To someone who understands mortgage underwriting, you should never, ever, ever do a zero down-payment mortgage. The fact that they were willing to try to do it until it was overturned shows that they did not have a complete grasp of their business.

Yes, CMHC absolutely must be supervised by OSFI, which is doing an outstanding job supervising the banks. Yes, it is an excellent idea to place two ministers on the board. Yes, a bank should not be allowed to insure conventional mortgages, that is, low-ratio or not high-ratio mortgages, through CMHC.

My only criticism of the budget bill in this respect is that the reforms of CMHC do not go far enough. The government, to use a metaphor I use a lot, has a very important role; it is the referee of the hockey game. We cannot have a hockey game or football game without referees. At the same time, the referee should not be owning or playing on one the hockey teams. The Government of Canada is the referee of banks and mortgages and the mortgage business, and they also own one of the players. Worse than that, they cheat, to use my language, because they give a 100 per cent guarantee to CMHC but only 90 per cent to the private sector. That is a conflict of interest. They have a 70 per cent market share, which is an unfair competitive advantage for using public funds against private firms in the private sector, the mortgage insurance companies. I do not consult or have any investments in any firms including mortgage insurance.

Government should be encouraging, not discouraging, private investment in Canada; yet the Government of Canada insures 100 per cent of CMHC's liabilities, which are up to a staggering \$600 billion or one third of Canada's GDP.

We can talk more but there is experience. Of course, the Australians privatized their version of CMHC, and the world did not come to an end in Australia — they did not have a collapse. Other things can be done, such as reinsurance and, I would hope, ultimately privatization. There are things that still need to be done with CMHC that are not yet being done.

I conclude my remarks here and am pleased to take questions.

The Chair: Ms. Londerville, please proceed with your opening statement.

Ms. Londerville: Thank you. I will echo some of the comments that you just heard. I appreciate the opportunity to appear before this committee. I have been a professor of real estate at the University of Guelph since 1993, teaching and doing research in the area of mortgage finance, among other things. I have written several articles for the Macdonald Laurier Institute that are on their website if you are looking for more information.

Canada can be justifiably proud of our mortgage finance system. Careful underwriting and legislation have allowed us to weather the global financial crisis better than almost any other country. The percentage of mortgages three months or more in arrears is less than one half of 1 per cent in January 2012; and it never really got up much higher than that during the crisis. While the system is strong, there are improvements that can be made. This proposed

legislation regulating covered bonds is important. Many European investors are not permitted to invest in covered bonds in countries where there is no legislation, so passing this will assist in the marketing of these securities and should bring additional funds into the mortgage finance system.

However, financial institutions are prevented in this bill from using insured mortgages as collateral, so they will have to pay a higher rate on these bonds than they would pay if they could use insured loans. It reduces demand for mortgage insurance, particularly on those loans that are below 80 per cent that do not really need to be insured. Overall, I think it is a sensible measure.

This bill also recognizes the major shift in CMHC's focus over the years. Mortgage insurance and securitization is a growing portion of the corporation's activities, relative to those related to social housing. Private mortgage insurers are overseen by the Office of the Superintendent of Financial Institutions; and this moves CMHC into that realm as well. I do not anticipate the annual reviews by OSFI will raise alarms because CMHC has been very prudent in their management of their mortgage insurance portfolio and holds twice the reserves recommended by OSFI. I think it is a good measure.

The bill also places the Deputy Minister of Finance and the Deputy Minister of Human Resources and Skills Development Canada as ex officio members of the CMHC board. The second position is important as it is critical in any effort to properly oversee the commercial activities undertaken by CMHC that we do not forget the vital role to be played in housing policy and the provision of affordable housing for lower income households and individuals in Canada. These activities have been overshadowed by the attention paid to the growing portfolio of insured mortgages. Since HRSDC is responsible for the federal homelessness programs, it is important that they remain connected with CMHC.

The bill also requires that CMHC "make available to the public the books, records and information that are required by regulation." It is not yet clear what will be required under this, but I look forward to greater transparency of information from CMHC comparable to the private insurers, as Professor Lee mentioned. Despite the positive aspects of the proposed legislation, there are a couple of remaining concerns.

As a Crown corporation, CMHC mortgage insurance policies are implicitly 100 per cent guaranteed by the government under the Basel Accord. If you are a banking institution, you do not need to hold any capital reserves against those. The government protection limit for private insurers is only 90 per cent. As a consequence, banks whose loans are insured through a private firm must set aside some capital reserves against the possibility of default. Thus, rates of return are higher on CMHC-backed mortgages for a bank. When profit margins are thin and banks are nervous about their capital reserves, as in the financial crisis of 2008, this makes a major difference. The evidence of this impact is in the growth in CMHC's mortgage insurance premium income during 2008 and the drop in Genworth's rate—the major private insurer at that time.

CMHC argues that the difference in guarantee is necessary because of their social mandate and the fact that they insure multi-residential buildings. In their latest annual report, they state that 46.5 per cent of their total rental and high-ratio business address gaps in the marketplace left by private sector competitors. This is where more public access to CMHC data would be helpful. CMHC has a monopoly on the provision of insurance of loans of multi-family buildings — private sector insurers are not permitted to insure those. If the private sector is not permitted to compete, then it does not make sense to include them in loans in any comparison with them. As well, there is no indication that CMHC does not make a profit on the provision of this insurance as they do on the homeowner insured loans.

According to the 2011 census, only 13.3 per cent of Canada's population was in the territories or remote from census metropolitan areas and census agglomerations, which makes me question that 46 per cent figure by CMHC. An objective, thorough analysis of the geographic location of privately insured loans relative to CMHC insured loans is necessary to back that statement up. I would be surprised if there is any material difference. A private insurer who refused to insure a loan on a remotely located property would not receive much future business from the financial institution they turned down.

The lender, not the borrower, decides who will insure a mortgage, CMHC or a private investor. The implication of this for consumers is reduced choice. This is not a competitive marketplace with consumers freely choosing which company will insure their loans, even though they are the ones who pay the large upfront fee for this insurance. CMHC has 70 per cent of the market. One party with such a dominant share of the market implies inadequate competition. To make this a truly competitive market, changes to the 90 per cent guarantee are necessary either by reducing CMHC's guarantee, moving the mortgage insurance business out of that organization, or raising the one for the private sector.

To conclude, I welcome the introduction of this bill. I believe that by leveling the playing field for private and public insurers by giving the same guarantee, consumers will benefit. There will be more private insurers competing for their business, ensuring competitive fees and greater incentives for product innovation.

The Chair: Thank you for those comments.

Senators, you will understand if you were listening closely to Professor Lee's opening comments that he last faced our friend and colleague Senator Harb in the 1993 election. Hence, since he had 5 or 10 minutes for his opening statement, it is only appropriate that I turn to Senator Harb to ask the first question of his opponent of several years past.

Senator Harb: He is a fearless leader who is not afraid to express his opinion, as you have noticed.

Professor Lee did not mention many things in his presentation. He has extensive experience in government restructuring and government organizations. In particular, Professor Lee was involved with the recommendation of the Nielsen Report. Perhaps he can tell us briefly about that experience, why it is so important that you appear before us today, and why it is so important for us to take what you are telling us at face value.

Mr. Lee: Certainly. I do not want to exaggerate the role that I played. Shortly after I started my doctorate in public policy, I was employed in the Privy Council Office, which of course supports the Prime Minister of Canada. I was in the machinery of government. That was in the spring, summer and fall of 1985. The then Mulroney government had been elected on, among other things, a campaign of privatization. When they looked into it, they discovered they did not have an inventory. The Government of Canada at the time did not have a comprehensive — it had a partial but incomplete — inventory of all government agencies, Crown corporations, tribunals and so forth. It was a fascinating experience, I assure you, for a PhD student to construct the document that eventually was adopted. Others vetted it and it was eventually taken over by the Treasury Board Secretariat. At the time, there were over 450 agencies on that list. It was astonishing. The 1917 Halifax Relief Commission was still operating in 1985, and other such agencies. That was the lead up to the then rationalization for the privatization and the rationalization, including subsequent changes to the Financial Administration Act.

Senator Harb: Our other witness spoke a bit about the social housing component of CMHC. I believe that there are thousands of units across the country that somehow CMHC was involved with at some time. CMHC is turning a profit on an annual basis for the Government of Canada. There are those who say that the government should look at taking part of that profit and putting it back into social housing, if not create more social housing, to retrofit the existing social housing, which is in terrible decay all across the land. Do you subscribe to that?

Mr. Lee: I am going to be very direct with you. I certainly will not beat around the bush, as you know. Social housing is very important and there is a need for it, I completely agree, but I do not believe the federal government should be providing it. That is why we have the provinces. This is in their bailiwick. This is under the Constitution Act.

The paper I am working on will advocate the transfer of the dollars, the resources, the people — not shutting it down, transferring it — to the provinces where it properly belongs. The provinces are closer to the people, the individual Canadians than the Government of Canada here in Ottawa and the

Rideau River and the Rideau Canal. Yes, it is important but it is not the role of the Government of Canada. There are other things that are very important for the Government of Canada, but I do not think that social housing is one.

The Chair: Professor Londerville, what impacts might you expect there to be to Canadian borrowers as a result of the stronger governance and regulatory regimes on mortgage insurance proposed in this budget implementation bill?

On the other side of the coin, what risks do you view there would be for Canadian taxpayers if Parliament does not act in regulating the mortgage insurance industry?

Ms. Londerville: I would not see a huge impact on borrowers as a result of this. We have set the criteria for what you need to qualify to get a mortgage loan. They have been tightened three times in the last few years. I think they are in pretty good shape right now, so I would not see borrowers seeing any huge impact from that.

The covered bonds might bring more money into the system, which might help; bigger supply of funds, lower cost. I would see a bigger impact on borrowers from this. Again, I do not see CMHC's portfolio as terribly risky right now. Certainly they have a lot of loans in their insured portfolio that are under 80 per cent loan to value, so they are not hugely risky. I think it is reassurance and oversight as we go forward that they are keeping enough reserves. I think they need to be under the same supervision that private insurers are. If we are implicitly backing them more than we do the private companies, we should be overseeing them the same way.

The Chair: Thank you for that succinct answer.

Senator Hervieux-Payette: I usually speak French but the translation might not be that good on the television. My question is addressed to both of you.

I bought a house nearly 20 years ago in Europe. My term was 15 years and I had to put 40 per cent down. This was the norm for everyone, not just because I was from Canada. Here we have played with these terms and conditions for quite some time. If it could be done on an incremental basis, what would be the most secure and fairest way of bringing the terms and conditions to a point that we minimize risk?

What would you say to CMHC, Genworth and the rest being only 80 per cent insured? This is in terms of having banks assume part of the risk and probably do their due diligence a bit better in some instances which we saw on the other side of the U.S. border, which was not done carefully. I do not think anyone is challenging to have the oversight of OSFI.

I want to remind you, Mr. Lee, that the terms and conditions were not CMHC's decision; they were the Minister of Finance's decision. They were changed in the last six to seven years. Personally, I feel when people buy a house and put very little money down, they can walk away from it when times are not good. They do not lose anything because they have invested almost nothing.

What would be the ideal situation so that we have fairness in the system, but at the same time the whole financial sector and the \$600 billion would not continue to rise to a point where half of the GDP is invested in mortgages?

Mr. Lee: I appreciate your questions because I think this goes to the very essence and core of those related questions. Let me deal with them serially. I want to compare and contrast it to when I was a mortgage manager in the 1970s. That is when the boomers were young and we were all buying houses, if I could remind everyone.

The down payment requirement was 10 per cent, not 5 per cent. It was 5 per cent for 30 or 40 years until the late 1990s when it ranged from 10 down to 5, which I think was a big mistake. The amortization when I was manager was 25 years. There was no such thing as a 30 or 35 year mortgage. Heaven forbid, no one even contemplated 40 years. There were no HELOCs, interest only or variable rate mortgages. There was a lot less consumer choice. I will come to the second question, but just to show it did not affect risk.

At the time Paul Volcker was the Federal Reserve Chairman after Reagan became President, interest rates drove to over 20 per cent. I was the mortgage manager when rates were at 20 and 21. I am smiling when people say, "My goodness, the mortgages might go from 3 to 5 per cent in Canada. What is going to happen?" I was there when they were 20. The delinquency ratio in Canada went from one half of 1 percent to 1 per cent. I provided that figure to the Ben Tal, the Deputy Chief Economist at CIBC who has done good work on that.

Risk minimization is the question. There is no question both in research and practice that skin in the game is the driver. The higher the down payment, the lower the delinquency ratio; the lower the down payment, the higher the delinquency ratio. When Congress went to zero down-payment mortgages, it was completely predictable that it would cause a housing crash. There is zero risk; no skin in the game.

More down payment is better than less. When I suggested that recently they say, "How can young people buy houses?" The same way we did for years and years. You went to your first source of financing, your parents — called love capital — and got the down payment. That was the norm. That was the first one.

The second one — I am glad you brought this up — was the government guarantee versus whether we should be downgrading it. I see the government guarantee as competing with regulation as a policy instrument. That is to say if you have rigorous — which we do have in Canada through OSFI — regulation of insurance companies as we do with Great-West Life, Sun Life, the casualty companies, property companies and the life insurance companies, they are all regulated and do an excellent job within OSFI. You do not need the government guarantee, the 80 per cent. I would say go to zero but make sure that OSFI is equipped with the regulatory tools for mortgage insurance to ensure the risk is minimized through regulation rather than government guarantee.

The Chair: Professor Londerville, anything you would like to add?

Ms. Londerville: Yes, a couple things. Having that guarantee allows the government at this time to really enforce those rules. We will not let you borrow 35-year amortization and get it insured. Yes, we must have specific regulations and oversight if we are going to get rid of that guarantee entirely.

The other thing is that it is not easy in Canada to walk away from a house and say, "Here are the keys back, I do not want it anymore. It is not worth what my mortgage is." You will have a judgment against you. Until you clear that you will not be able to buy another house. It is much simpler in the U.S. to go to the bank and say, "I am done, I am not making any more payments," and a year later buy another house. You cannot do that in Canada. The consequences of foreclosure are much greater in Canada. Yes, bigger down payment; I do not have as much of a problem with a 5 per cent down payment. I was not a big fan of zero, but I think 5 per cent is okay. The fact that the consequences of foreclosure are so high in Canada helps.

People stay in their houses, even when the value may be below what the mortgage amount is, because they want to keep it and rebuild that equity.

Mr. Lee: Can I respond to that quickly? I appreciate very much the professor's comments.

This has been said many times in Canada, that the risk of the bank going after you for deficiency changes the rules of the game.

I can state that in practice I know of no bank or mortgage manager — it may have happened — who has ever sued on deficiency. You write it off. First off, if you are foreclosing, the person probably has serious problems. They were probably unemployed, or they have skipped or have no assets. You do not throw good money after bad. Yes, theoretically you can sue for the deficiency. The reality, the practice in banks — and I would urge you to get a banker to testify — I think you will find it is extremely rare to sue for the balance. The option is there, but you do not do it. It is partly bad public relations and partly it is pointless; why throw good money after bad?

[Translation]

Senator Maltais: Professor, I just want to say that, based on how fast you went through your opening statement, your 60-minute lectures must take 10 minutes.

In your brief, you say that banks should take on more responsibility in terms of insurance and push aside the Canada Mortgage and Housing Corporation. Is my understanding correct? Ms. Londerville says that the Canada Mortgage and Housing Corporation funding 70 per cent of housing is too much.

Mr. Lee, you have been working in the mortgage industry for a long time. Do you know why the Canada Mortgage and Housing Corporation was created? It was created because banks have not been taking care of Canadians, and when they do lend them money for a home, they bleed them white. Thirty years later, banks are waking up. Too bad for them.

When you say that the government has no social role to play in housing, you are going completely against what the Canada Mortgage and Housing Corporation stands for. That organization was created to help young couples, young workers, buy a house at a lending rate different from that offered by banks.

Today, I want to give credit to the insurance companies that were the first and the only ones to trust little Canadians, while big financial institutions would lend money only on \$500,000 houses whose owners had \$2 million deposits.

[English]

The Chair: Senator Maltais, I am going to interrupt. I know you are not a professor, but I will ask you to state your question.

[Translation]

Senator Maltais: Do you still believe that banks should provide more insurance and buy shares from the Canada Mortgage and Housing Corporation?

[English]

Mr. Lee: I am not sure that I understand that question, but I will ask you to rephrase it. I just want to respond to the second question.

Transforming CMHC or privatizing it will not end mortgage insurance. It will not end the lending of money to young people to buy houses. This is purely an instrument. The end of CMHC does not mean the end of mortgage lending or the end of the ability of young people to purchase a home. This is merely an instrument to achieve the end of being able to purchase a house.

On the other side, the 70 per cent figure was the percentage of all the mortgage insurance contracts in Canada provided by CMHC. In other words, they have a 70 per cent mortgage error. CMHC is underwriting 70 per cent of the high-ratio mortgages in Canada, where the two private firms have about 30 per cent.

The Chair: Professor Londerville, do you wish to comment?

Ms. Londerville: Yes. I think that mortgage insurance is a critical tool to allow people to buy a house without a huge down payment. It is very important for young people and so on.

Both CMHC and the private insurers make a lot of money doing it. I argue that maybe the fees are a little too high for it, and there are other ways to structure fees that could be considered. As Professor Lee says, it is not going to go away. If CMHC is not doing it, there will be many private sector companies that would like to do it.

[Translation]

Senator Maltais: You think that banks are losing money?

[English]

Ms. Londerville: No.

Mr. Lee: I will answer that. There is also something the senator said about the banks used to be very difficult about lending money. Up until, I believe, 1968 — I stand to be corrected on this — the Bank Act, passed by the Parliament of Canada, prohibited the banks from lending anything other than highly securitized mortgages. The Bank Act, up until 1968 prohibited personal lending by banks, and they prohibited what we would now call personal lending of all kinds. Banks were purely commercial banks prior to 1968.

It was only after 1968 amendments, in the early Trudeau administration, when the Bank Act was liberalized and the banks were allowed to get into credit cards, consumer loans and mortgages, and then they went and raided or hired all kinds of people from the consumer loan or finance companies, called Household Finance, Beneficial and Traders and companies like that.

[Translation]

Senator Maltais: Why have they changed their minds if they wanted to get involved in that market?

[English]

Mr. Lee: The answer is very clear. I know this committee has addressed this, and I will not get into that, in terms of credit card rates and so forth. There are three broad product lines in lending for a bank. There are mortgage loans, which have the lowest risk of all. The risk to the bank for a mortgage is extremely low for anyone to default and walk away. I think I had one foreclosure in four years.

Consumer loans have higher risks, and by that I mean car loans. That is why they carry a higher interest rate. The losses on consumer loans are higher than on mortgages, but much lower than credit cards. Credit cards have the highest interest rates because they give them away like candy to almost anyone, including people who are unemployed and do not have a job.

My point is that the risk is lower for mortgages because it is more difficult to get a mortgage from a bank than a credit card. The risk is lower, the interest rates are lower and the losses are lower. Yes, it is profitable. Banks do not make loans to lose money.

Senator Ringuette: As a long-standing member of this committee, I remember the relaxing of mortgage loan approval in the 2007-08 budget bill. That is not too far away, then two years after they had to come back to the 2007-08 mortgage insurance provisions.

Professor Lee, something many Canadians may not be aware of is that one of the major differences between the U.S. and Canadian mortgages is the fact that private home mortgages are income tax deductible in the U.S.

Mr. Lee: True.

Senator Ringuette: Interest payments are deductible, so people and banks would tend to offer a lot more loans.

Ms. Londerville, in your statement you say that in this bill, from using insured mortgages as collateral, they will have to pay a higher rate on these bonds than if they could use insured loans. You are talking about financial institutions in Canada.

I deduce from this that it is going to be more costly because of the higher rate for covered bonds for our financial institutions, if it will be more costly for them to get the liquidity in the market, that will be transferred with regard to the mortgage rates for Canadians. Do you agree with that?

Ms. Londerville: This is an additional source of funds for the banks, so it is a new way for them to raise money, secured by mortgages they have on their books. I am saying they have to pay a higher rate than if they could put insured loans in there, but they also have more investors who are allowed to invest in them because we have the regulations going into place.

I do not really know what the net effect of those will be. They are against each other and I do not know what the net effect would be.

Senator Ringuette: I want to commend you on putting this forth to us because not only you but highly sophisticated economic and financial analysts have also indicated the same thing in recent weeks.

Mr. Lee: Senator, you are absolutely right. It will increase their cost of borrowing but in a very small amount because the Canadian banks are extremely large and extremely well capitalized. Right now they are getting an unfair subsidy from the taxpayer of Canada, from CMHC.

Senator Ringuette: I remember not too long ago that they got \$69 billion worth of subsidy through the repurchasing of loans.

Going back to this current bill with regard to the covered bond, I have here an entity called Fitch. They are New York-based and they analyze all these mortgage securities. They say this measure will probably increase the cost of mortgages in Canada. In Reuters, an article from London, England, says that in the European experience with regard to covered bonds, it has increased the cost of mortgages for homeowners.

I would like you to try to explain the reality of what will happen in the market and the end result for the homeowner who requires a mortgage.

Ms. Londerville: The banks have been very small in their issuance of covered bonds so far. To me, it is a new way for them to bring in more capital. They are securing them with mortgages they have on their books, so they are pretty safe investments.

As Professor Lee says, Canadian banks are pretty well respected as an investment around the world. Yes, they would have to pay a higher rate than if they could put insured mortgages in there, but I do not see it will be a huge difference in cost. The mortgage market is very competitive still in Canada, and rates for homeowners have been quite good over the last while.

Bringing in more funds is a greater supply to the financial market, so I do not see how that overall would raise rates, or not significantly.

Senator Tkachuk: I have a few questions. We talked about the cost of social housing. Are the revenues CMHC produces used to subsidize the cost of social housing within the corporation?

Mr. Lee: No, there is essentially a firewall, so there is a separate budget line for social housing. Money is fungible. They bring in \$1 billion of profit and give it to the government; the government gives them back some money to do social housing. Technically, they are accounted for by a separate flow of funds.

Senator Tkachuk: Do you know what the cost is of the social housing part of the CMHC?

Mr. Lee: I do not have that. I have always focused on the mortgage insurance because it has such an impact on the mortgage market. I have not focused on social housing.

Ms. Londerville: I do not know that off the top of my head, but I think they should be separated. I do not think we should be saying, okay, first-time home buyers, pay your mortgage insurance and we will use that for social housing. I think it should be all our responsibility to fund social housing. There is a role at the federal level as well as the provinces.

Senator Tkachuk: As you both know, the government has not only CMHC but it has other banks: Business Development Bank, Farm Credit Canada. Should those also be governed by regulatory bodies?

Mr. Lee: If you are asking me, I distinguish commercial crowns that are competing in the marketplace from a social government corporation such as CBC, which is delivering social programs.

Senator Tkachuk: I would like to see them regulated, too. Nonetheless, we will deal with Farm Credit and Business Development Corporation.

Mr. Lee: The so-called commercial crowns under the Financial Administration Act are the ones that have their own boards and so forth and they are competing for capital with the private sector. If they are a bank or a near bank, they should be regulated. Governor Carney has spoken about this and so have I. Near banks have been getting away with a lot of things because they are not regulated like banks. A near bank is a leasing company, GE Capital, all the auto leasing companies. Farm Credit Canada is a near bank. It is any financial institution that looks like a bank, acts like a bank but is not regulated like a bank.

Ms. Londerville: I would agree with that. If there is competition with the private sector in some way, then they should be under the same rules.

Senator Massicotte: I gather the bottom line is that relative to the proposed amendments, you both agree with what is being proposed. Am I correct in saying that?

Mr. Lee: Yes.

Senator Massicotte: If we are having a chat among us girls, you are basically both saying "If I had a magic wand, I would also privatize CMHC." Are you both saying that?

Mr. Lee: I am, because we want to encourage a private market. The argument, of course, is that mortgage insurance is very important. My response to that is, I have had one mortgage insurance contract with CMHC in my life when I was in my 20s. I eat three times a day, I think that is very important, but we have not nationalized Loblaws or Provigo, and that is very important.

My point is, if we can have private life insurance companies and private auto insurance companies and casualty companies, we should be fostering a —

Senator Massicotte: Ms. Londerville, do you agree with that? You also would privatize CMHC?

Ms. Londerville: I think it would have to be a gradual move to that. I am not maybe as firm on that as Professor Lee, but I think certainly we need to level the playing field so that they are competing as the private insurers do and then gradually the market share would shift. Right now, if we tried to sell the mortgage insurance portion of CMHC, it is a pretty big buy.

Senator Massicotte: Are you saying we should privatize so they have a level playing field? It seems the more significant argument would be private enterprise, when there is significant competition, basically provides better value and does not need sheltered money. Is not that the stronger argument than a level playing field?

Mr. Lee: It is a more efficient economy when you have private firms because they do not have an unfair competitive advantage. That is the problem.

Senator Massicotte: I will take the argument further. You go to regulations. If you believe in the market approach, there are only two reasons you should regulate. One is systemic risk, too big to fail — the same thing as we are finding around the world, that institutions are too big to fail — and another is consumer protection. If you think that this is complicated and consumers need protection, they need a father figure holding their hand when they take a mortgage, one could argue there is significant competition where no one player is very large — contrary to the case with CMHC — and you should let it be totally unregulated. The consumer knows the interest rate. He will know that. There could be some fees. I think the average consumer is knowledgeable enough to make that decision, so why regulate if there is no systemic risk? If there is systemic risk, I agree; you have to get there, but if there is none, why not allow real competition?

Mr. Lee: Maybe this is systemic risk or maybe it is a third reason. Financial institutions are completely virtual; that is to say, they are financial and digitized. You can get runs on banks or financial institutions. We are seeing it right now before our eyes in Greece, Spain and Italy, where there is deposit flight. You cannot have a run on a manufacturer. I just stop buying GM's cars and their market share goes down, but in a bank, because banks and financial institutions are so interconnected, I suppose this is the systemic risk.

Senator Massicotte: Then deposit insurance is all you can do. So what if they suffer? If you just give a loan, if they go under, they do not have to pay it back. Why would we subsidize the shareholders?

Mr. Lee: I guess I will work from a different side. We have the most successful financial system in the Western world because, and there is a lot of evidence on this, we have regulated banks in a superior manner to the United States or Europe. We do not have the uncertainty that the latter causes to business, which feeds back into economic growth. There is a pro-business argument in favour of regulation of financial institutions.

Senator Massicotte: We are just having a debate but the United States have filed a regulation relative to the Volker Rule that is so burdensome and applies to so many institutions that they are going to retract. You are right: It could diminish risks, but why would you burden companies that have no affect on the economy or society if it does fail.

Mr. Lee: Canada's financial rules are principles-based, and the American model is much more prescriptive in that they are trying to anticipate every situation. Our model of regulation is superior as well in Canada.

Senator Moore: I would like one of you to tell us what the difference is between a covered bond and the stacking and parceling of mortgages that was taking place at the start of the recession?

The banks were parceling off the strata of mortgages and selling them in bundles. I want to know the difference between that and a covered bond.

Mr. Lee: Are you referring to the American practice that was going on with securitization?

Senator Moore: I think some of our banks were doing the same thing.

Mr. Lee: I will give a partial answer. First, securitization was much more extensive in the United States than it is here. If I am not mistaken, and I stand to be corrected, it is only about 30 per cent. It has always been a much lower figure in Canada with Canadian banks. They keep their own mortgages on their books. They were securitizing when I was a mortgage manager. We would sell off once a year, and I would get a note saying that they had sold a bundle to Sun Life; but we continued to manage them on the Bank of Montreal books.

First, they do a lot more securitization in the United States. Second, they do not have uniform standards of mortgage underwriting in the U.S. Going back to Senator Ringuette's comment earlier about the interest deductibility, that is one difference and the second difference is that the banks are much more aggressive in the States than in Canada. They are what we used to call "go-go bankers" as opposed to "prudent balance sheet lenders" in Canada. We used to say that. Third, they have this plethora of regulations.

The standards are much more uneven. Here, mortgages are almost fungible, even though they are lent to individuals, because the rules are very homogenized. The Bank of Commerce and the Bank of Montreal are applying the same sets of rules.

Senator Moore: I know that.

Mr. Lee: That makes it easier, paradoxically, to securitize.

Senator Moore: What is the difference between the securitization of a bundle of Canadian mortgages and the covered bonds that Canadian banks deal in? I do not understand the difference between the securitization of a bundle of mortgages and covered bonds, which are also secured by a bundle of mortgages, I think.

Ms. Londerville: In the covered bond situation, the mortgages stay on the bank's books; so they remain part of the bank's assets. They are segregated such that if that bank went bankrupt, the covered bondholders have first claim on those mortgages to recover their bond money. With securitization, they are selling the mortgages off their books to CMHC; and they are gone.

Senator Moore: Professor Londerville, with regard to the discussion on the possible privatization of CMHC, I believe you said earlier that they have \$600 billion in outstanding mortgages. I do not know what the mortgage insurance portion of their business is. You said that it would be a pretty big buy. What is the amount of business that CMHC does in insuring mortgages? Do we know that?

Ms. Londerville: They have \$600 billion worth of mortgages insured. They are close to that with \$560 billion or so.

Senator Moore: Thank you.

Ms. Londerville: The limit now is \$600 billion.

Senator Stewart Olsen: I have a brief question for both of you. If you moved to privatization, in essence what would happen to the social aspect? I am a bit concerned. You are saying devolve it to the provinces, but I am not sure what you suggest would happen in that case.

Mr. Lee: That is why I mentioned that CMHC has five lines of business doing very different things. The statisticians and economists group is very large and is doing fantastic work. They could be moved into Stats Canada, who is supposed to be doing the number crunching and collecting.

Social housing is a completely different business from mortgage insurance. One is social and the other is commercial. Mortgage insurance is no different than property insurance or casualty insurance, whereas social housing is a social policy — a social welfare function. Even if they did not privatize it, social housing should probably be in a different agency.

Former Prime Minister Trudeau created a ministry for housing in the early 1970s. A former mayor of Toronto was the head of. The agency was separate and apart from CMHC. It was doing a lot on social policy. I see them as two very different items, and they do not have to be under the same roof.

Ms. Londerville: I would agree with that. It is a critical function and we cannot forget about it in this discussion of what is going on in terms the business side of CMHC. We do not want to forget about the social policy. There is a big role at the federal level for helping to set a national housing policy and criteria and then working with the provinces to ensure that we have enough money to deliver those programs. We have underfunded that whole sector for decades.

The Chair: Professors Lee and Londerville, I express our great appreciation for outstanding, enlightening and informative presentations.

We are pleased to welcome from the Canadian Life and Health Insurance Association, Mr. Frank Zinatelli, Vice President and General Counsel; and by video conference from Toronto Ms. Diane Urquhart, Independent Financial Analyst. Both panellists are here to discuss Division 22, which deals with the Canada Labour Code and long-term disability plans. We have approximately one hour for this session.

Ms. Urquhart, we will hear from you first, followed by Mr. Zinatelli, after which we will have questions.

Diane A. Urquhart, Independent Financial Analyst, as an individual: Thank you very much for inviting me to make the presentation from Toronto to your committee. I will be focused on sections 434 to 439 in the 2012 budget bill on disability insurance.

Let me start by saying that mandatory disability insurance is the best solution for eliminating unsafe corporate, self-insured LTD benefits.

As an independent analyst I fully agree with section 239.2(1), which sets out this new requirement under the labour code. Many of you will remember me as having worked with the Nortel disabled former employees, and making a presentation to your committee a little over a year ago. I have continued to work with that group to find solutions for their specific tragic situation, and those whom I speak to also fully agree with section 232.2(1). Even though it does not help them, they are most supportive of legislative change at the federal government such that in the future employees of federal regulated corporations who offer long-term disability benefits will be obliged to have insurance and, as a consequence, there will be no disabled workers for federal registered corporations that will suffer the experience they have had.

To briefly comment on why I am so strongly in support of this mandatory insurance provision, and not to take away from the presentation we will hear from Mr. Zinatelli but perhaps to strongly support the view that licensed insurers should be involved in the provision of this mandatory disability insurance, because the life insurance industry is well regulated today by the provincial financial service regulators and by the federal Office of the Superintendent of Financial Institutions.

The advantage of having gone this way rather than to develop a new regulatory structure is that we have one that works well today. One of the big advantages of being in this structure is that we do not need to build a new regulatory infrastructure with more government cost. Let us use the one that we have and there will be no extra costs associated with that.

Disability insurance policyholders also get higher priority in the bankruptcy of bankrupt insurers under the federal Winding-Up and Restructuring Act so we will not have the problem we had in Nortel, where the policyholders and the disability insurance that was sold by Nortel as the corporate sponsor ended up being equal to the unsecured creditors.

You will all remember the debates on the Companies' Creditors Arrangement Act and the Bankruptcy and Insolvency Act. With this mandatory change at the federal level, and on the assumption we will see the same change in all the provinces of Canada, it is no longer necessary to make an amendment to the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act for the purpose of protecting disabled workers of Canada. If the provinces follow this, then all the private corporations of Canada will be obliged, if they offer long-term disability benefits, to do so by buying those benefits from a licensed insurance carrier.

I have been contacted by people in Quebec, and it is very likely that they will adopt the same provision, mandatory disability insurance for LTD plans at Quebec corporations. We have received communications from both Alberta and Ontario indicating that they are actively studying the matter as well.

The life insurance industry also has Assuris, so we have the third level of protection there in the event that a disabled policyholder of an insurance company is in the unfortunate situation of their insurance company going bankrupt. Then there is another level of insurance facility available collectively from the insurance industry.

I will turn to provision 239.2(2):

However, an employer may provide those benefits under a long-term disability plan that is not insured, in the circumstances and subject to the conditions provided for in the regulations.

The regulations have not yet been released. I would recommend that the only exception be the federal government and the federal government Crown agencies and that no private sector employer be permitted to be exempt under any circumstances. I will be looking forward to those regulations.

Turning to what will be the consequence for a federal private corporation that does not comply with the requirement for mandatory disability insurance, I would simply make the point that the objective of the Labour Code amendment must be to set a standard of mandatory insurance. However, but I am concerned that the \$250,000 penalty for failing to comply with the federal Labour Code is far too low and will not act as a significant deterrent.

To give you perspective on that, \$250,000 is the maximum fine. In our Nortel case, the range of damages, that is the damage for a single Nortel disabled person, we have damages as high as \$550,000 as a result of Nortel having underfunded its disability income benefits for its workers.

I suspect it is far too late in the process for this to be the case, but to the extent that your committee has the opportunity to make further amendments, I would recommend that the maximum fine be increased to \$5 million. We have to be in the millions of dollars because it is only large corporations that would opt to try to self-insure disability benefits. Those large corporations will have hundreds of employees.

To give you perspective, in the Nortel LTD case the underfunded benefits were \$50 million to \$75 million. If you have to waive paying a \$250,000 fine versus potentially keeping \$75 million for your bondholders, you may be inclined to not bother with the mandatory insurance, not be concerned about the Labour Code and pay the \$250,000 fine.

Turning to the Transitional Provision, section 438, the reason I am sure they are on a going forward basis is that to not do so would cause retroactive elements for this amendment to the Labour Code. The way the transitional elements work is that if you are already disabled or if you have already made an application to receive disability benefits, then you will not be subject to any benefit from this change in legislation. It will apply only to all the active workers who are going to get some new protection that they did not otherwise have.

In conclusion, I am very happy with what we see here. I would like to see a higher fine amount. It goes without saying that if it is a fine, this legislation has done nothing for the disabled workers who are specifically precluded from receiving any benefit in the transition clause, but it is clearly a positive step for the future.

I will spend a couple more minutes, and I see there are only two speakers for the hour, so you must have allotted a lot of time for questions. I want to make a brief comment on the situation for those who are currently disabled and not receiving protection. In particular, I bring to the attention of this committee that there are 360 Nortel disabled and 120 children who have been pushed into poverty. After 14 months since this committee recommended that there not be a retroactive change in the CCAA and BIA, there has been absolutely no progress made on behalf of this group.

We have a situation now where these families have been paid 35 per cent of what was owed to them, a 65 per cent cut in their income. You will also recall that these were people who, for the most part, cannot go back to work given the nature of their genetic diseases and their severe physical injuries from accidents. They are still faced with a tragic situation. They have been paid already now about three to four years of income, and that is pretty much what they would expect to get.

We have people like Jackie Bodie, a young onset Parkinson's with two young children. Two incomes are required to support her home. She is in a position that while she is 40 years old, she needs to live on three to four years of income until she is 65.

We still consider this situation to be a severe injustice for the Nortel disabled engineers, scientists and many other well-educated former employees who, through no fault of their own, are now pushed into poverty without a remedy for what I have expressed before and for which we have firmer belief today: There were misrepresentations in the disability insurance that was supplied to them by Nortel and their money was wrongfully removed from the trust account.

In closing, as you might expect by now, you can see this group is not willing to give up, nor am I. As a financial analyst who has been working with them, I feel they have been wronged and an injustice has occurred. A petition was filed this week on Monday by the Progressive Conservative Party of Ontario. In this petition, the Nortel disabled group — with the support of the PC Party of Ontario and the New Democratic Party of Ontario — is asking for the Ontario legislature to instruct the Ontario Ministry of Consumer Services to enforce the Ontario Consumer Protection Act in respect of unfair business practices and false and misleading deceptive representations by Nortel and Sun Life in the disability insurance supplied to Nortel's employees.

I ask all members of this committee, all members of Parliament and the Senate to support that petition. This group has faced an injustice and it is unfair they face a life of poverty when money was taken from their trust account.

The Chair: Thank you, Ms. Urquhart, for your opening comments.

Frank Zinatelli, Vice President and General Counsel, Canadian Life and Health Insurance Association: Thank you. It is a pleasure to be here and to be able to speak this time. I was under the weather a bit the last time I was here.

I am Frank Zinatelli, Vice President and General Counsel of the Canadian Life and Health Insurance Association. I would like to first thank this committee for the opportunity to contribute to your review of the divisions of Bill C-38, the Budget Implementation Act 2012. With your permission, I would like to make some short introductory comments.

The Canadian Life and Health Insurance Association represents life and health insurance companies accounting for 99 per cent of the life and health insurance in force across Canada. The Canadian life and health insurance industry provides products which include individual and group life insurance, disability insurance, supplementary health insurance, individual and group annuities — including RRSPs, RRIAs and TFSA's — and of course pensions.

The industry protects more than 26 million Canadians and over 45 million people internationally. The industry makes benefit payments to Canadians of \$64 billion per year. It has almost \$514 billion invested in Canada's economy and provides employment to nearly 135,000 Canadians. Life and health insurers are regulated at the federal level under the Insurance Companies Act and are also subject to the rules and regulations set out in provincial insurance acts.

We welcome this opportunity to appear before the committee as you seek to develop your report to Parliament. The industry is very supportive of some of the divisions contained in this bill. Let me comment on two of them. I will comment more fully on Division 22 and very briefly on Division 2.

Division 22, as Ms. Urquhart noted, would amend Part 3 of the Canada Labour Code to require federally regulated private sector employers that provide benefits to their employees under long-term disability plans to insure those plans, subject to certain exceptions. This would require employers who have uninsured long-term disability plans to insure them so that in the case of bankruptcy, employees on long-term disability at the time of the bankruptcy will continue to receive those benefits as long as they are disabled.

The Canadian life and health insurance industry is very supportive of this legislative initiative. We believe it is critically important to ensure that employees on long-term disability are protected in the event of a plan sponsor's financial stress or insolvency. History has shown that when an employer becomes insolvent and its LTD plan is uninsured, disabled employees can sometimes lose their benefits. Ms. Urquhart spoke of one example. We know that about 10 years ago there was the Eaton's situation and 10 years before that there was the Massey Ferguson situation.

Senator Hervieux-Payette: Singer sewing machines.

Mr. Zinatelli: That is right.

Currently in Canada there is little regulation of uninsured LTD plans. There is no requirement that employers set aside adequate reserves to cover future liabilities arising from these plans. If reserves are set aside, there is no restriction on how those funds are invested. There is also no obligation to keep funds in trust to protect them from creditors. As a result, there are no protections in place to ensure there are adequate funds available to support ongoing LTD claims in the event of an employer's bankruptcy.

I should note that a couple of the provinces have some disclosure requirements in their provincial legislation at this time.

Requiring that LTD plans be offered on an insured basis provides the maximum protection for disabled employees and ensures they are paid, regardless of their plan sponsor's financial situation. We believe this is the best route to address the protection of those on long-term disability. With insured plans, the risk and financial liabilities for providing the LTD benefits are transferred to the insurer. The insurer's responsibility with respect to disability benefits continues even when the plan sponsor experiences financial difficulties or after the plan is terminated. Indeed, after a plan sponsor's bankruptcy, the insurer will continue benefits for disabilities that began while the group policy was in force.

In order to protect those on long-term disability, it is crucial that there be funds available to support all ongoing disability liabilities, even if the employer is bankrupt. We believe the legislative initiatives set out in Division 22 would be effective to achieve the public policy objective of fully protecting individuals on LTD.

As an industry, we are making representations to provincial governments recommending that they make equivalent changes.

I will now turn briefly to one other matter. We note that Division 2 of Bill C-38 would amend the Trust and Loan Companies Act, the Bank Act and the Cooperative Credit Associations Act to prohibit the issuance of life annuity like products. The provisions of the current legislation indicating that only life insurance companies can provide life annuities are relatively clear and I see this as a technical amendment that is helpful in reinforcing the rules and policy objectives that are already in place.

The industry greatly appreciates this opportunity to participate in the committee's review of Bill C-38, and I would be pleased to answer any questions that you may have.

[Translation]

Senator Hervieux-Payette: I think that we are strictly concerned with companies that come under federal jurisdiction. I have one question for both witnesses. Is it usual for this kind of legislation or other types of legislations — I have no expertise in this area — to require that the entire collective agreement be submitted? This case seems to be general, although I would think that the collective agreement provisions that concern that type of insurance could be submitted to the government. As far as I know, collective agreements — especially when it comes to large companies like Telecom — can be very important.

No one has said anything — including you and Ms. Urquhart — about the legislation requiring the whole collective agreement to be submitted. I do not know what the unions will say. Traditionally, does a collective agreement that may have hundreds of pages have to be submitted to the government when disability insurance provisions are being looked at? Does the whole agreement have to be submitted or only its relevant part?

As for the amount of the penalty, I agree with Ms. Urquhart that \$500,000 is not enough. Would you say that the \$500,000 amount is sufficient — especially since it is in your industry's interest of to know that people will really get insured — as they will pay premiums to your members? For instance, for a very popular campaign these days called the Canadian Pacific, I think that \$500,000 will not necessarily suffice to ensure that those people have to take out an insurance policy.

In conclusion, I have a question for Ms. Urquhart. If action is taken in Ontario for Nortel employees with the consumer agency, who would pay the premium? Would it be the Government of Ontario? Does Nortel have sufficient assets to pay? But technically speaking, you raised this issue, and I am wondering where the money could come from. That is because, even if a case is won, it is not much help if there are insufficient funds to pay the premiums.

My first question was about the whole agreement versus the insurance-related clauses. My second question was about the penalty amounts for companies that do not comply with the law. My last question was about Nortel.

[English]

Mr. Zinatelli: With respect to the first question, which relates to the collective agreements, I note that that provision of the Labour Code is not in the part in Part 3, as I understand, that relates to this particular initiative of the government, although I stand to be corrected.

With respect to the requirement I see in this part that deals with providing protection for persons on LTD, from what I read of the legislation, it simply appears to say that you have to inform the government that you have such a plan in place. It does not talk about the whole collective agreement, which I believe is in another part and may have other rationales attached to it. I have not looked at that aspect of it. You may want to check with experts on the Labour Code.

If you look at the part dealing with this particular aspect, it only talks about having to inform the government that you indeed have an insured plan.

[Translation]

Senator Hervieux-Payette: What about penalties?

[English]

Mr. Zinatelli: With respect to the penalties, I think one must be careful about increasing penalties too much. Remember that purchasing insurance is voluntary; employers do it in agreement with employees as part of the benefits they want to provide to encourage individuals to come and work for their companies. You do not want to put in disincentives that would drive an employer who would want to have the protection for employees to say, "You know what, the penalty is too high. I just do not want to take a chance." I think you want to create incentives for employers to create that kind of protection.

The Chair: Ms. Urquhart, do you want to comment on the penalties and who should pay?

Ms. Urquhart: Are you asking me to speak now?

The Chair: Yes, first on the penalties.

Ms. Urquhart: As I said in my prepared remarks, that \$250,000, the number I see in the version of the budget bill I have — whether it is \$250,000 or \$500,000 — is too little I would argue. For major corporations, we need to have penalties in the millions of dollars. If it is a high penalty, you are going to purchase the mandatory insurance. From the disabled perspective, certainly the group that has suffered the damages in the most recent case, they would rather have no insurance than have bogus self-insured insurance that is not funded.

The incentive is to purchase the mandatory insurance. If you purchase the mandatory insurance, there is no fine. If the consequence of that is you would rather not have insurance at all, I think the disabled persons who have been victims of not having the solvency of their disability insurance plan would rather not have a plan at all. If this were to be the case, they would know that they needed to purchase their own private personal disability insurance rather than have the false faith that they had received disability insurance coverage at work.

The next point, I am certainly not an expert by any means on collective agreements, but I would like to make a brief comment about multi-employer plans and health and welfare trusts and these new employee life and health trusts. It was the union movement that, after the Eaton's bankruptcy, was responsible for the Alberta government not proceeding with a proposal for mandatory insurance. They made the argument that it was not necessary to have mandatory insurance because the current self-insured plans were generally with their reserves held in trust and that we had breach of trust common law.

I would strongly suggest that we not subscribe to their opposition to mandatory insurance this time. They pretty much had their opportunity in the Nortel case for this matter to be brought to mediation or litigation on the matter of breach of trust, and the legal counsel who represents many of the unions did not even make that as a recommended action on behalf of the court-appointed representative for the Nortel disabled group.

Breach of trust common law does not work. The one major bankruptcy where we needed it, the legal counsel for many of the unions did not even recommend that it be undertaken, so the time is up, from my perspective. Whether it is the employer who is forced to have mandatory insurance once they decide to have an LTD plan or whether it is a union or a group of unions who themselves in consortium seek to have a multi-employer union-sponsored plan such as the GM Health Care Trust, then I would argue that the unions also be mandated to purchase insurance if they are going to offer long-term disability benefit plans.

The Chair: I think there was another question.

Ms. Urquhart: Do you want me to go back to the matter of the Ontario Consumer Protection Act?

The Chair: I would like you to give an answer to the question, which was, who was going to pay if you were successful in your case. That was the question. It should be a quick answer because we have other questioners.

Ms. Urquhart: The quick answer is the Nortel estate. Essentially, this would have to be a consumer agency enforcement action — charges laid of offences to the act. It is taken to another judge, not the bankruptcy judge, who adjudicates whether the conditions are in place.

The Chair: Thank you. I think you responded to the question that was asked.

[Translation]

Senator Maltais: Mr. Zinatelli, I would like to begin by congratulating you on your brief. It is well-drafted and in line with the law. I think that you have an openness that will help us avoid current problems in the future.

I am surprised that major companies have self-insured plans. Unions are somewhat to blame for that. When a company applies for group insurance, they always look for the cheapest option. The cheapest option may not necessarily be the most credit-worthy one that will provide long-term guarantees. As long as companies — both owners and workers — have this philosophy, they will be searching for the lowest cost. So they should not complain when they obtain nothing, as they have also given nothing, or almost.

Since we are talking about disability insurance, I would like to discuss the issue of pension funds. I have a concrete example. You know that in the forestry sector, companies like Domtar — and God knows that many have closed their books in Quebec — they have closed the employees' pension fund books as well. Those people end up with 40 per cent, 50 per cent or 35 per cent of their pension fund. While they have been expecting a \$50,000 pension, they end up with a \$20,000 one.

I do not know whether insurance companies could make sure that workers' pension funds are safe with companies? That is my last question, Mr. Chair.

[English]

Mr. Zinatelli: With respect to pensions, there are very important initiatives by the federal government to develop PRPPs — a new pension vehicle which, it is hoped, will assist more individuals. Quebec has introduced similar legislation, which I understand is moving quickly. There are some important developments on the pension side.

To get back to the long-term disability benefits issue, Ms. Urquhart mentioned Alberta. I want to note for the record that the CLHIA did not oppose moving to an insurance model in Alberta in 2002 or 2003 when that was being looked at. Obviously, we strongly support the current model.

In the context of reaching our policy position on this, we looked at other possibilities for how one can protect employees. We looked at disclosure as an approach, which can be helpful. You tell the person "Hey, this is not an insured product." The employer has the ultimate liability. You can also ask employers to create trust accounts, but then you have to ensure money is put into those trust accounts. At the end of the day, we concluded that you needed insured plans to create as much certainty as one can in this area that employees will be protected.

As Ms. Urquhart correctly pointed out, we are extremely well regulated as an industry. I think you heard some of that discussion with the previous panel. In the very unlikely event that an insurance company were to bankrupt, the industry would stand behind that company. Therefore, the payments for LTD are continued. There are some limits of \$2,000 per month or 85 per cent of the monthly benefit. For sure you will get that and possibly even more. There is very adequate insurance protection.

Senator Ringuette: Ms. Urquhart, it has been a long fight. Unfortunately, we could not get the bill for Nortel disabled employees. It is too late for them, but I hope it is not too late for other employees down the road that may be affected by bankruptcy.

You mentioned that the penalty is not high enough. Would you see a penalty being applied as a percentage of the not funded or maybe even the total required funds in the LTD? The concern is that if the penalty is not high enough, some major corporations like Nortel and others will laugh at it and prefer to pay the small penalty rather than put the required funds or the required insurance in the LTD.

Ms. Urquhart: I would not agree with a percentage of the unfunded liability or the deficit of the long-term disability plan because a fine is a penalty, which is to act as a deterrent, and the fine is paid to the Government of Canada. The victims receive no benefit. If you are a victim of the loss of your financial well-being, you would rather get compensation for your damages than see a large fine paid to the government.

I would weigh it this way: \$250,000 is so small that it will not even get the attention of the media or others in terms of the impact that there could be on reputational damage — to be found to have breached the Labour Code and to have caused harm to disabled persons of Canada.

I said \$5 million but I think that anything around \$1 million, \$2 million to \$5 million is enough that attention would be paid by the corporate human resources office and the chief executive officer to not wish to lose that amount of money. More importantly, the media and others would say that a company that did not purchase the mandatory insurance under the Labour Code and paid a fine of \$5 million would probably get publicized. Hence, that, too, would deter others. Yet, not so much money is taken that the victim has no money left.

Senator Ringuette: You are also saying that the specific penalty should be put into some kind of employee protection LTD plan from the Government of Canada. Is that right?

Ms. Urquhart: It would be good under the Labour Code — and I am not familiar enough with the Labour Code with respect to other matters — such that if you breached the code, you would be obliged to pay restitution to the victims damaged as a result of your offence. I would be happy if there was no fine at all but rather a restitution order. I would agree for sure if we had a restitution remedy instead of a fine that it pay all of the deficit because of the peace-of-mind nature of the insurance policy and the fact that there was an opportunity for the employer to buy a third-party licensed, insured product, which was much safer and better regulated, without meaningful additional costs.

Senator Ringuette: That makes perfect sense to me.

Mr. Zinatelli, you provide insurance to these companies.

Mr. Zinatelli: Yes.

Senator Ringuette: What are the statistics with regard to the Canadian company and the insurance that they have on the LTD?

Mr. Zinatelli: I do not have the numbers with me, but I would be happy to provide the committee with numbers that might be available on that. We generally have the numbers on the insured plans. It is much tougher, and there is not that much information on the uninsured plans because they are not part of our —

Senator Ringuette: You do not know what is the possible market?

Mr. Zinatelli: We have some general numbers, guesstimates, if you like.

Senator Ringuette: Give us a guesstimate in the meantime.

Mr. Zinatelli: I will look for one that is in some —

The Chair: Will you provide that information to the clerk? She will see it is circulated to the members.

Mr. Zinatelli: I would be happy to do that.

I want to come back to what you were just discussing, but I also should note that I have three copies of our policy paper here which might be helpful. I think it has some of the numbers in there, which perhaps we can look at afterwards with the clerk.

I wanted to get back to the previous discussion that you were having with Ms. Urquhart. I looked at the provision of the act because for a minute I was not sure, but what I understand the legislation to say is, effectively, if you provide long-term disability, then it has to be insured — if you provide it.

You do not want to discourage employers from doing something positive that they would want to do, that they want to collaborate with their employees in doing. I think it is important not to put in disincentives on an employer doing the right thing along with their employees. Raising penalties and trying to punish employers who are coming to the table in good faith might be negative in that respect.

Senator Ringuette: You also understand that having a group of employees, like in the example of Nortel, that were always under the impression that their LTD plan was covered because, never mind a bankruptcy situation, it did not interfere either way in regard to their disability status. It was quite a shock, the reality of the bankruptcy and the major loss of benefits that they face.

Mr. Zinatelli: As in many things, senator, it is a question of creating the right balance.

Senator Ringuette: I think this is at least a little step in creating a balance. Thank you.

The Chair: That concludes our questions. On behalf of the entire committee I would like to express to Mr. Zinatelli and Ms. Urquhart our grateful thanks for appearing before us today. You have been very helpful in our deliberations.

(The committee adjourned.)