Submission to the Nova Scotia Pension Review Panel

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an ACS company

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Executive Summary

The primary emphasis of our submission is to recommend that the regulatory framework for both defined benefit (DB) and defined contribution (DC) pension plans be revamped to create the following registered pension plan landscape:

- Comparability between DB and DC – allow greater flexibility in DB plan design (especially the single employer private sector) to allow DB plans to become competitive with DC plans;
- Funding rules – establish funding rules that recognize the uniqueness and the fixed contribution requirements of plan sponsors of multi-employer pension plans (MEPPs) and a proposed new plan design (Target Benefit Plan, see page 8) and remove solvency funding requirements that really do not make sense for these types of plans;
- Plan administration – ease some of the administrative burden on DB plans and encourage more companies to embrace DB plans;
- Benefit adequacy – continued focus on benefit adequacy and security for DB plans and an enhanced focus on minimum retirement income for DC plans;
- Surplus asymmetry – accommodation within pension regulation that assigns surplus ownership in some proportion to those taking the risk;
- Governance - a solid foundation of good governance and full disclosure of information to plan members of both DB and DC plans;
- Pension buy-out fund – a non-profit post retirement government sponsored central fund that allows plan sponsors to transfer large pensioner liabilities in a secure, cost efficient manner; and
- Regulatory harmonization – provinces need to band together to make a uniform set of rules for plan sponsors to simplify the existing overly complex administrative issues faced by plan's in multiple provinces;

We believe the above regulatory framework will produce more plan members and a greater level of post-retirement wealth whether delivered through a defined benefit or defined contribution plan, thus avoiding the social and economic issues that "pensioner poverty" would cause. Furthermore, we believe that our submission will help Nova Scotia achieve the five goals of pension legislation outlined in your discussion paper.

Absent serious changes to the current regulatory framework in Nova Scotia (and all provinces for that matter) we believe that the following trends will continue:

- DB pension plans will die a slow death especially in the single employer private sector; and
- DC pension plans will continue to provide inadequate information and more importantly inadequate retirement income to too many plan members.

We welcome the pro-active stance taken by the Nova Scotia government in its formation of the Nova Scotia Pension Review Panel and would be happy to participate in any further discussions and/or meetings.

Overview

We welcome the opportunity to present our views and recommendations to the Panel with respect to the sustainability of the pension plan system in Nova Scotia. Our submission is designed to increase pension plan coverage (i.e. the number of plans established and members participating) and improve the overall level of member benefits.

Defined Benefit Plans

We believe that the defined benefit pension plan will continue its decline in the single employer private sector if regulatory action is not taken immediately. Without serious efforts to address the current problems in operating defined benefit plans, the trend away from defined benefit plans will inevitably continue, to the point where the only defined benefit plans remaining will be the union-sponsored plans, public sector plans and MEPPs.

There is an urgent need to allow the creation of defined benefit plans than can at least compete on cost with defined contribution plans so plan sponsors can have an opportunity to choose from an array of defined benefit and defined contribution coverage. While our bias naturally leans towards defined benefit plans, a level playing field must be created to give plan sponsors an adequate choice of plan design with a reasonably degree of cost certainty.

In the current regulatory environment the combined effects of: contribution volatility and cost uncertainty, plan design inflexibility, surplus ownership uncertainties and accounting issues are suffocating defined benefit plans and forcing employers towards defined contribution plans. Immediate action is needed to reverse this trend.

Defined Contribution Plans

Defined contribution plans fail too many plan members in that i) complex risks are offloaded on plan members without being well understood, ii) plan members are largely unequipped to self manage the risks, and iii) plan members do not realize the returns they forego due to investment management fees typical of a self-directed defined contribution plan. The end result of all of this is inadequate retirement income for too many defined contribution plan members.

Furthermore, defined contribution plans have been allowed to drift towards an individual consumer mindset. That is, current practices force unprepared participants to take the responsibility to invest for their long term future, using investment funds that underperform and are over priced.

The removal of risk-pooling mechanisms inherent in defined benefit plans, the lack of hands-on professional money management, the higher investment fees and, in some cases, broker commissions have all contributed to an inadequate level of retirement income under defined contribution plans as compared to defined benefit plans.

Most Canadian pension legislation was written in the late 1980's and does not specifically address defined contribution plans. Admittedly, pension regulation has been updated periodically since then but at best offers not much more than a patchwork quilt of legislation. The Capital Accumulation Plan Guides released in 2003 as industry "best practice" offers a refreshing approach to self governance for sponsors of defined contribution plans and may offer the best starting point for a new defined contribution approach.

The Target Benefit Plan design outlined on page 8 addresses some of the major challenges faced by employers with traditional defined benefit plans. These challenges consist of contribution volatility and uncertainty, surplus ownership uncertainty, accounting issues and the burden of regulatory compliance and administrative rules. From a defined contribution perspective, a Target Benefit Plan addresses or reduces the impact of many of the challenges faced by defined benefit plans.

In the balance of this document, we have responded to the Panel's questions in the order raised and our responses to your questions echo the themes we have presented.

Response to Panel's Questions

Pension Plan Legislation

Question:

Should pension legislation and regulation have goals other than those listed?

Response:

Coverage

We believe that one of the public policy goals of a pension regulatory body should be to encourage and promote increased coverage levels under registered pension plans within its jurisdiction. It is well documented that coverage levels of the Canadian population under private sector defined benefit pension plans has been shrinking and will continue to do so unless action is taken. The minimum statutory membership and vesting requirements within a provincial pension act should reflect the public policy objective of increasing coverage levels. Incentives to employers in establishing or retaining a registered pension plan should be created as a matter of public policy.

Currently employees can wait up to two years before being eligible to join a pension plan and then another two years before becoming vested. Therefore an employee may have to wait up to four years before becoming entitled to <u>any</u> benefit. With today's mobile workforce it is not uncommon to see employees change jobs every few years. An employee can potentially be in the full time workforce (working for companies who sponsor pension plans) for many years without ever becoming vested in any pension; in today's mobile workforce this isn't fair to employees.

Central "retiree" pension fund

We propose the creation of a fund (called, for example, the Nova Scotia Retiree Pension Fund or NSRPF) managed by an organization that would accept asset transfers from registered pension plans and assume the responsibility for the payment of pensions to the plan's retirees and beneficiaries.

Transferring a company's pension liabilities to the NSRPF would reduce the weight and volatility of these liabilities on its financial statements and significantly reduce its risk.

The NSRPF would be a not-for-profit organization or a crown corporation operating at arm's length to the government, so costs would be minimized.

The transfer of the retirees' obligation would not be mandatory; each plan would decide whether it wants to participate or not. A plan sponsor that decides to participate would be required to transfer all pensioner liabilities to the NSRPF, as well as all the liabilities of future retirees, as they retire.

Plans could therefore annuitize their retiree liabilities to the NSRPF, which would price the cost of transfers on a sound actuarial basis at a fair price without any profit margin but with a proper provision for adverse deviation.

This centrally-managed fund would likely become very large over time. This would allow expert management of a large pool of assets which we see as being largely, if not totally, invested in bonds. The specialized nature of the NSRPF would enable the application of advanced risk management techniques adapted to annuities.

Types of Plans

Question:

Are there plan designs not in use that would provide the benefits of defined benefit plans while minimizing risk?

Response:

Target Benefit Plan

The need to create defined benefit plans than can compete with defined contribution plans could be addressed by the creation of an alternative plan design referred to as a "Target Benefit Plan", a type of plan modeled after the MEPP concept.

The fundamental difference between a MEPP and a typical single-employer defined benefit plan is the nature of the underlying pension promise. In a MEPP, the basic pension promise is defined contribution for employers, or “contingent defined benefit” for employees. It is contingent on a pooling of assets to fund the benefits so that, even though the objective is defined benefit (i.e., “target” benefit), the promise in reality is defined contribution.

The employers’ liability is limited to the negotiated contributions. Therefore, as in the case of defined contribution plans, the members are the ultimate bearers of the risk (although in the case of a MEPP the members bear the risk collectively, while for most defined contribution plans they bear the risk individually).

The members receive benefits based on what their employers pay for, through the negotiated fixed contributions. Effectively, then, the members are the owners, beneficiaries, and risk-takers of these plans which means that they assume the resulting fiduciary risks and investment manager governance responsibilities.

We see a Target Benefit Plan existing within the following framework:

- A legal framework to allow a single employer to set up and sponsor a Target Benefit Plan, patterned along MEPP lines with a “contingent defined benefit” promise.
- Availability for both union and non-union employee groups to participate.

- A mandatory governance and disclosure structure designed to ensure members understand the promises and comittements underlying the plan.
- An appropriate governance structure that would be supported by the following documents:
- A plan text.
- A funding policy.
- An investment policy.
- A sponsorship agreement, employment contract, or collective bargaining agreement.
- A trust agreement.
- A plan member communications policy.
- Member communication material.
- Employer and member contribution rates* based on a percentage of earnings.
- Target benefit rates* based on a career, final average earnings or flat dollar formula.

* Although the target benefit rate and contribution rate are typically flat dollar in a MEPP, this does not necessarily need to be the case in a Target Benefit Plan.

The most significant issue to be addressed through dialogue with pension regulators is the appropriate governance structure of such plans. In order for such plans to be successful outside of a union environment, a governance structure would need to be established that would:

- Protect the interests of plan beneficiaries
- Ensure that assets are invested in a manner that minimizes the risk of benefit reductions
- Protect the employers against potential litigation if target benefits are less than expected.

A funding policy would be an important component of the governance structure of such plans and would need to address such items as:

- Appropriate cost method.
- Provisions for adverse deviations.
- Intergenerational equity.

We believe that legislation enabling Target Benefit Plans to be set up outside of the union, multi-employer environment is critical to the future success of defined benefit plans. The Target Benefit Plan design will provide the needed flexibility to employers of defined benefit plans struggling with how to move forward in the changing demographic and economic environment.

Defined Benefit (DB) Plans versus Defined Contribution (DC) Plans

Questions:

Should the current trend towards less DB plans be accepted, or should regulators permit DB plans that may be more attractive to employers by reducing funding risks? In the case of DC plans, to what extent should an employee's right to make investment choices be limited, and by whom? Should new forms of DB pension plans be permitted to enhance their availability? Should new forms of Hybrid pension plans be permitted to enhance their availability? Should DC members have the ability to use different disbursement options, such as LIF type payments, rather than be required to convert funds on their retirement date?

Response:

We believe there are up to five "problems" facing defined benefit plan sponsors today. Our opening statement at the beginning of this submission made the point that we need to make defined benefit plans more sponsor friendly and allow creative and innovative plan designs that can complete with defined contribution pension plans.

Standing in the way of achieving this objective are a number of "problems" related to defined benefit plans that we wish to highlight for the Panel. These "problems" are not new; therefore we have kept the following overview brief:

Surplus/Deficit Asymmetry

Problem: Sponsors of defined benefit plans currently operate in an environment where they must bear the responsibility for funding deficits but have limited access to plan surplus. The requirements to share or distribute surplus to plan members in partial or full wind-up events, even in cases where the documents grant surplus entitlement to the plan sponsor, have caused many plan sponsors to adopt a policy of "minimum funding" and maximum use of contribution holidays, to the detriment of benefit security for plan members.

Solution: The Government of Nova Scotia should enact legislation that provides clear and fair rules surrounding surplus ownership that reflect the risk sharing arrangement implemented by the employer.

Funding volatility and solvency requirements

Problem: Many plans are faced with solvency deficiencies. Since solvency liabilities must be valued using a discount rate reflecting the current bond market, there is also volatility in the solvency liabilities and hence in a plan sponsors' contributions. The funding volatility for companies with large, mature pension plans whose pensioner liabilities are significant in relation to the size of the sponsoring company has become especially problematic. In order to provide more predictable results to investors, companies are abandoning defined benefit plans in favour of defined contribution plans.

Solution: The Government of Nova Scotia should adopt guiding principles which are reasonable and consistent and address the severe problems faced by employers. We have outlined our views of solvency funding in the following section “Pension Plan Funding” (see page 12 for details).

Accounting Rules

Problem: Accounting rules have only exacerbated the problems currently being faced by plan sponsors of defined benefit plans. The reluctance to contribute more than the minimum amount required by law, together with the requirement to use corporate bond rates to value pension liabilities, have lead to significant pension expense volatility. And the requirement to show the entire funded position of the plan on the company balance sheet has put extreme pressures on corporate balance sheets. This is especially problematic for companies with large pensioner liabilities.

Solution: While the Government of Nova Scotia cannot change the accounting rules, it does have the power to modify the regulatory framework in such a way that will provide companies with defined benefit design options that will relieve the current pressures put on their corporate balance sheets by current defined benefit plan designs.

Administrative complexity and lack of uniformity

Problem: We’ve seen a significant increase in the administrative complexity of defined benefit plans, with the growth of provincial minimum standards legislation in the 1980s and 90s and the pension tax reform of the early 90s. The complexity has been compounded by the inability of the provincial regulators to attain any kind of uniformity in the legislation. Today, companies who sponsor defined benefit plans who have employees in every province must deal with nine sets of pension rules plus the additional reporting requirements placed on plan sponsors as a result of pension regulators attempts to streamline its regulatory role and focus on “risky” plans. This equates to operational cost, risk and time commitment on the part of plan sponsors.

Solution: The Government of Nova Scotia can take a leadership position on harmonization initiatives and demonstrate to the private sector community that progress will be made on this very important issue. We have outlined our views on harmonization initiatives in the “Pension Plan Legislation” section (see page 7 for details).

Globalization

Problem: In today’s economy, manufacturers, and to a certain extent resource companies, must compete against US, European and Asian competitors for customers. In most of these other geographic locations, the defined benefit plan is no longer the norm. Thus Canadian companies must compete against competitors that are not burdened by the risks and costs associated with a defined benefit plan. As such, Canadian manufacturers are currently forced to convert to a defined contribution plan design unless the government fundamentally revises the Pension Benefits Act to allow employers to mitigate defined benefit risks. Initially the exodus from defined

benefit will be in the manufacturing sector, but taxpayers will eventually demand that public sector plans be revised to mirror the post retirement reality of the majority of taxpayers. Final pay defined benefit public sector plans may soon become a target for taxpayer groups.

Solution: While the Government of Nova Scotia cannot change the competitive forces of globalization, they can influence how companies with defined benefit pension plans address some of those competitive pressures on a domestic level. The message we have consistently delivered in our submission is to create defined benefit plans than can compete with defined contribution plans. By doing so, not only will plan sponsors have an opportunity to choose from an array of defined benefit and defined contribution coverage but they will succeed in controlling the burdening risks and cost volatility and uncertainty of current defined benefit plan designs.

Pension Plan Funding

Questions:

Are current rules for measuring and remediation of going concern and solvency deficits appropriate? Should there be exceptions to the funding rules for universities, multi-employer pension plans and municipalities, or anybody else? Should going concern funding still be a requirement? Should promises as to future benefit accrual be restricted to the level that can be funded by contributions? Should there be a requirement for full funding at wind-up?Is the idea of a province wide pension plan for some public or private employers a good idea? Should such a plan operate as a multi-employer pension plan?

Response:

Solvency funding should be based on the following guiding principles:

- Solvency rules should recognize the long term nature of pension plans.
- Solvency rules should not force financially healthy companies to fully fund solvency deficiencies in times of historically low interest rates.
- Solvency rules should not apply to pension plans when it is clear that a pension plan will never wind-up.
- The requirement to fund for solvency should be dependent on the risk sharing nature of the plan.
- The financial position on a solvency basis should be transparent, and should not be clouded by "smoothing techniques" or excluded benefits.
- Solvency rules should be designed to protect the pension benefits of employees who work for financially "at-risk" companies.
- Solvency rules should not put healthy companies at risk.

Following from the above principles, our proposals for solvency funding rules are:

- MEPPs should not have to fund for solvency. A full explanation of this proposal is explained in the article, “MEPPs: To Solvency Fund or Not”, attached as Appendix A. (An abridged version of this article appeared in the May 2007 issue of Benefits and Pensions Monitor.)
- A "Target Benefit" Plan (see page 8 for details) should not have to fund for solvency.
- Public sector plans should not have to fund for solvency. These plans are unlikely to wind-up and have the financial backing of taxpayers.
- Private companies can and do go bankrupt and when that happens, it tends to happen fairly quickly. It would be more beneficial for both plan members and the plan sponsor if the solvency funding objective were to fund a substantial portion of the wind-up liability within a shorter period of time, instead of requiring 100% funding over 5 years.
- For traditional DB plans where the sponsoring company is responsible for funding the deficit, we propose the following:
    - Remove the distinction between solvency and wind-up liability. This means that solvency liability would include any inflation protection guaranteed under the terms of the plan.
    - For plans that are less than 80% funded on a wind-up basis, require that the portion of the wind-up deficiency below 80% be amortized over 5 years by level monthly payments. Require that the remaining 20% be amortized over 15 years.
    - For plans that are at least 80% funded on a wind-up basis, require that the wind-up deficiency be amortized over 15 years.
    - Allow greater flexibility in the use of actuarial gains to reduce previously established special payments.
    - Remove the option to smooth asset values and liabilities.
    - Allow the use of financial instruments such as letters of credit to guarantee amortization payments for solvency deficiencies.
- Completely remove any requirement for grow-in. This legislated benefit ultimately resembles a form of severance to a specific group of employees that would be more appropriately, and more equitably, handled under employment standards legislation. Solvency funding should reflect what members are entitled to on a valuation date if the plan was to wind-up on that date, not what they might be entitled to if the plan was to remain a going concern.

Surplus

Questions:

Should regulators speak to the question of the ownership of plan surpluses? If so, what should it say? Is the concept of “deferred wages” valid? And if so, is there any current validity to it with respect to the determination of the responsibility for funding and for entitlement of surplus?

Response:

There is an urgent need to create clear and fair rules around surplus ownership that are compatible with the particular risk sharing arrangement.

The issue of surplus use and ownership should be addressed by the legislatures, not the courts. This means that legislation needs to be passed establishing the application of contract law for pension plans and overriding common law trust precedents.

The legislation should establish clear and fair rules around surplus ownership that are compatible with the particular risk sharing arrangement.

The application of contract law to decide issues around surplus use and ownership would mean that parties to the pension deal could decide, under the terms of the plan text, collective bargaining agreement or other such contracts, how surplus will be used or shared.

Allowing contract law to prevail would foster an environment where companies can manage the pension plan funding risk and where pension deals would be transparent for all parties.

If a plan sponsor wants to operate a traditional defined benefit plan and take full responsibility for the funding risk of that plan, then that plan sponsor should have access to the surplus in order to be able to manage the funding risk properly, unless that particular pension deal calls for a different surplus sharing arrangement.

Multi-Employer Pension Plans

Questions:

How should funding concerns for MEPPs be addressed? Would permitting the implementation of a different type of Hybrid pension plan be useful for MEPPs? Which of the funding tests should apply to MEPPs? Should regulators facilitate the further development of hybrid plans? Would the Quebec model be an attractive option for Nova Scotia employers?

Response:

We believe MEPPs require a distinctive regulatory environment from that of the typical single-employer defined benefit plan. We have previously addressed our views on solvency funding for MEPPs in the “Pension Plan Funding” question on page 12.

If regulatory rules permitted different types of Hybrid plan designs, then we believe the industry would respond with innovative MEPP plan designs. Such as a combination defined

benefit/defined contribution hybrid which provides a floor defined benefit formula of say 1% of earnings with a 3% of earnings defined contribution top-up.

Governance

Questions:

Should government attempt to define, audit, and regulate "good governance"? Why or why not? Is so, what types of governance issues should be regulated? Given that there are associated costs with governance, what is an appropriate cost for "good governance"?

Response:

Government should create a best practice framework from which "good governance" will follow.

We believe that were the funding of a pension plan is shared; plan governance should reflect the responsibility of each of the plan funding stakeholders. We do not believe that mandatory legislative provisions nor mandatory pension committees are the solution.

At a minimum, governance documents to support a pension plan should include:

- A funding policy that would set minimum funding levels and parameters around the use of surplus
- A communications policy to ensure that plan members understand the pension deal, the financial position of the plan, and their own level of benefit security.

Role of Regulators

Questions:

Does the current regulatory system work effectively? Are there currently unnecessary rules and regulations in place? If so, what are they? Should the appeal process be changed? If so, how? Should a plan have a minimum number of members before the government will regulate it? If so, what minimum number of members would be appropriate?

Response:

The current regulatory regime needs to be improved as it can and does have a major impact on a plan sponsor's business. The regulatory review process needs to be streamlined and excessive delays on plan mergers and asset transfers removed. The provincial regulators need to seriously review harmonization issues and make progress in resolving these issues as insufficient progress has been made too date.

We would encourage the Panel to review whether it would be feasible for Nova Scotia to adopt another jurisdiction's legislation (similar to a participating employer under a pension plan). As the Pension Benefits Acts of both Ontario and Nova Scotia are very similar it may make sense for both provinces to adopt the same act.

Alternatively, we would suggest that the Maritime Region should have one Pension Benefits Act covering the all the Maritime Provinces which would be administered by one combined Maritime regulator. Regional regulatory centers could still exist to regulate plans in those provinces using the “Maritime Pension Benefits Act”.

Group Registered Retirement Savings Plans (G-RRSPs)

While a response was not specifically requested on this topic, we would like to offer our viewpoint.

GRRSPs fall under the “best practice” principles of the Capital Accumulation Plan Guidelines and all major financial institutions and Employers adhere to the principles of these guidelines.

The increase in GRRSP type programs is a direct result of the defined benefit problems addressed in this document. The trend towards GRRSPs started during the late 1980s and early 1990s as result of extensive changes made to both provincial pension benefit acts and the Canadian Income Tax Act. The GRRSP alternative has been embraced by businesses as a cost effective alternative in which to provide retirement wealth accumulation to employees; and GRRSPs have been very successful in attaining that objective.

We agree that one of the challenges for GRRSP programs (and other defined contribution type programs) is the engagement of employees to take responsibility for investment decisions that impact their wealth accumulation. We would like to point out that this challenge also exists for a defined contribution registered pension plan which are and have been subject to ”the protection of the Pension Benefits Act”. Clearly too date, the Pension Benefits Act has not been successful in addressing this challenge.

Subjecting GRRSPs to the registration requirements of the Pension Benefits Act would, in our opinion, be a mistake and may trigger the redesign or even termination of many GRRSPs. We would encourage the Panel to look to the existing Capital Accumulation Plan Guidelines as way to fine tune the challenges facing these types of programs rather than embarking on a legislative remedy.

Unlocking Funds

Question:

To what extent should regulators attempt to regulate an employee’s right to access funds?

Response:

The primary purpose of a registered pension plan is to provide members with a periodic retirement income.

While we support the introduction of initiatives to give members flexibility in providing retirement income, there has been a growing trend across Canada to permit former and retired members to unlock a portion of their pension value on retirement and potentially received the monies in cash.

We are concerned that being able to receive pension monies in cash is counter to good public policy.

Employers incur large costs to sponsor and maintain registered pension plans for the benefit of plan members so that plan members can be provided with a periodic income in their retirement years. We believe that the trend of unlocking undermines the primary purpose of a registered plan and regulators should be careful in balancing the needs of public policy and plan member wants.

Grow-in Benefits

Questions:

Should the legislation require grow-in benefits to be provided on plan wind-up? Should legislators maintain the requirement to fund grow-in benefits upon wind-up?

Response:

The Panel should refer to page 13 where grow-in benefits are addressed relative to solvency funding. In summary, we recommended removing grow-in benefits from the Nova Scotia Pension Benefits Act.

If grow-in were removed and vesting were made immediate upon plan membership, then there would be no need to administer partial wind-ups, since (with the possible exception of surplus entitlement) members would receive the same benefit on partial wind-up as they would in a normal termination situation.

"Safe Harbour" Rules

Question:

Should "safe harbour" rules be established that would give DC plan sponsors and administrators protection from litigation?

Response:

In our view, the notion of "safe harbour" is attractive to the extent that in order for it to provide the appropriate protections to Employers certain roles and responsibilities would have to be solidified in law. As an initial step, we would like to see safe harbour rules introduced over time in the following general phases:

Phase 1 - Tighten up the Capital Accumulation Plan guidelines through a consultation process similar to the process used to form the guidelines.

Phase 2 – A trial transition period of up to two years in order to evaluate the changes.

Phase 3 – Review whether certain aspects of the Capital Accumulation Plan guidelines should become law and implement safe harbour protections for Employers.

The current guidelines are well tested but need an adjustment based on real life plan experiences to date. We believe that the Capital Accumulation Plan guidelines should be reviewed with the following points in mind:

- Investment education versus advice - how do sponsors implement advice capabilities so that members can get advice without fear of being tied to the providers of advice? How do advice providers get monitored and by who?
- What types of funds can be used as default funds? How they should be monitored? Should plans actually be required to have a default fund?
- How should multi-manager structures be monitored and communicated to members?
- How should fees be measured relative to what is considered fair value? Is the measurement based on the sponsor or members perception?

Phased Retirement

Question:

What other issues are raised by phased retirement and what should be the regulatory position of Nova Scotia?

Response:

We believe one of the primary questions that must be addressed by provincial regulators is the employer's ability to select the skilled workers to whom phased retirement can be offered. While the Income Tax Act does not restrict or prescribe which employee classes can receive phased retirement benefits, provincial pension benefit act restrictions may be problematic to the widespread adoption of phased retirement benefits by employers. We would encourage the Panel to consider providing employers with sufficient flexibility under the pension benefits act to allow phased retirement benefits to be offered to select individuals or groups of individuals.

An equally important issue is who pays for the phased retirement benefit provided under a plan? Phased retirement legislation adopted too date in Canada requires that a written agreement should be in place between the employee and employer. The agreement would specify the cost sharing arrangements between employees and employers. The Nova Scotia Pension Benefits Act would need to accommodate (or at least not restrict) any agreed upon cost sharing arrangements to be made between an employee and employer.

Tax Free Savings Accounts

Question:

What should be the regulatory position of Nova Scotia be with respect to TFSAs for pension purposes?

Response:

The new Tax Free Savings Account (TFSA) vehicle will become a significant investment option to Nova Scotians. From speaking with our clients, we are aware that many employers are reviewing how TFSAs can be harmonized with existing employer sponsored retirement/savings programs. We, therefore, expect that Group TFSAs will become a reality and will be embraced by employees. We believe that Group TFSAs will fall under the Capital Accumulation Plan Guidelines and as such afford participating employees with best practice protection.

We would encourage the Panel to provide flexibility to employers to utilize TFSAs within a retirement program structure. For example, under a defined contribution retirement program structure, the program could consist of a TFSA and a defined contribution registered pension plan. Employee contribution would be made to a TFSA while basic and matching employer contributions would be made to the registered pension plan. From speaking with policy staff at the Financial Services Commission of Ontario (FSCO), we are aware that FSCO are receptive to this type of structure as long as certain prescribed policy conditions are met as outlined in FSCO pension policy F800-400 (Employer Contributions based on RRSP Contributions).

As a TFSA is an employee controlled general savings vehicle (which would fall under the Capital Accumulation Plan Guidelines) our position is that it does not make sense that it should be subject to registration with a provincial pension regulator. To do so, would undermine Employer plan design flexibility in assisting employees achieve their wealth accumulation goals.

APPENDIX A

MEPPs: To Solvency Fund or Not

By H. Clare Pitcher

The most critical issue facing multi-employer pension plans (MEPPs) today is solvency funding; at best, it could mean a substantial reduction in benefits, even accrued benefits including those of pensioners; at worst, it threatens their very existence. While solvency funding may be the most "politically correct" and "regulatorily expedient" thing to do, it is clearly the very wrong thing to do!

Within the broad range of pension arrangements offered in Canada today, MEPPs are unique. It is that uniqueness which underlies the reasoning to not fund these types of plans on a solvency basis.

Definitions

Let us first of all be clear on the types of plans to which we are referring. Essentially, we are including those types of pension plans which are "specified" as per the federal Income Tax Act, i.e. so-called specified multi-employer pension plans (SMEPs). These plans have several participating employers and are typically union-negotiated/collectively-bargained and either joint labour-management or 100% union-trusteed. Employer contributions, typically cents per hour, are fixed as per the negotiated collective bargaining agreement (CBA) and go into the plan on a defined contribution (DC) basis; benefits to members, typically flat benefits, are defined by a formula or a scale and come out of the plan on a defined benefit (DB) basis.

While DB plans define the benefits (with the contributions being variable) and DC plans define the contributions (with benefits being the variable), MEPPs define both the benefits and the contributions. This is the essence of their uniqueness.

The Canada Revenue Agency views these plans as DC, while the Pension Benefits Acts of the various jurisdictions across Canada view them as DB plans. Clearly, they have elements of both. For greater certainty, we are not referring to the large public sector MEPPs, which are essentially DB plans.

In going-concern funding – which applies to all DB plans – the funding target is set assuming the plan will continue into the future indefinitely, actuarial assumptions are long-term, and unfunded liabilities are typically required to be funded over 15 years. In solvency funding, on the other hand, the funding target is set assuming the plan will terminate immediately (as of the valuation date), actuarial assumptions are prescribed based on current settlement rates, and solvency deficiencies are typically required to be funded over 5 years; its purpose is to protect the benefits

in the event of plan wind-up, which makes sense in the case of single-employer pension plans because of the possibility of a single employer's insolvency.

Nature of Underlying Pension Promise

There are a number of factors that differentiate MEPPs from the typical single-employer defined benefit (SEDB) pension plan, the most fundamental of which is the nature of the underlying pension promise.

Very simply, in a MEPP the basic pension promise is DC, or "contingent DB". It is contingent on there being enough assets to fund the benefits so that, even though the objective is DB (i.e. "target" benefit), the promise in reality is DC. The employers' liability (other than in Quebec) is limited to the negotiated contributions. Therefore, as in the case of DC plans, the members are the ultimate bearers of the risk; the members get what their employers pay for, through the negotiated fixed contributions. Effectively, then, the members are the owners, beneficiaries, and risk-takers of these plans. The members, through their representatives (the Trustees), determine the (DB) benefit payouts; furthermore, the Trustees have a fiduciary responsibility to the members to ensure that the pension promise is kept.

In this context, solvency funding has no relevance. On plan wind-up, unlikely as that is, the liabilities of the plan are by definition equal to the assets; if the accumulated assets are less than the otherwise-applicable liabilities, the plan has the ability to legally reduce the benefits. Clear and full disclosure and communication to plan members about the nature of the promise and the inherent risks to members is therefore very relevant and critically important.

Security of Benefits

Most, if not all, regulators across Canada will tell you that the reason for solvency funding is to improve the security of the benefits. This is true in respect of single-employer plans (because additional contributions get put into the plan), but it is simply not true in the case of MEPPs.

The reality for MEPPs is that solvency funding does not improve the security of the benefits since, unlike the case in respect of single-employer plans, it does NOT result in more money being put into the plan (because the contributions are fixed by collective agreement). Solvency "funding" is therefore a misnomer in the context of MEPPs. What it may do, of course, is force the benefits to be reduced. [Therefore, solvency "reductions" is probably a better name for it.] On potential plan wind-up (the risk against which solvency funding is designed to protect), members simply end up with a higher percentage of a lower benefit, which is exactly equal to a lower percentage of a higher benefit. The illusion of enhanced benefit security simply means less adequate benefits.

So, solvency funding clearly does nothing positive for a MEPP plan member. Tragically, however, it can potentially and has historically, especially over the past few years, very seriously hurt these plans and their members.

Stability of Contribution/Benefit Rates

Rate stability – both contribution and benefit – is critical for MEPPs because of the defined contribution / defined benefit nature of these plans. Solvency funding, based on current "point-in-time" long-term bond interest rates, is extremely volatile and, since contributions are fixed by collective agreement, can and will result in the benefits bouncing all over the map. In whose best interest is that?

Going-concern funding (based on long-term actuarial assumptions for the future) – not solvency funding – enhances the stability of these plans.

Unnecessary Reduction in Benefits

The primary practical mechanism in these plans to deal with a solvency deficiency (assuming the insufficiency of the existing contribution rates and any contingency reserve) is a reduction in the benefits. In the current environment of low interest rates, benefits get reduced. Then, current interest rates rise and the benefits are reinstated and perhaps even increased. This is the volatility referred to above.

Ultimately, the benefit levels will "average out" based on the long-term experience of the plan. But, in the meantime, benefits – perhaps even the benefits of pensioners on fixed incomes – will have been reduced. Then, when they are reinstated, the pensioner may be dead. In whose best interest is that?

Clearly, the security of the benefits has been compromised. The regulators' primary overall objective is benefit security, which in single-employer plans they hope to achieve through solvency funding; ironically, in the case of MEPPs, solvency funding has exactly the reverse impact and the objective will not be achieved.

Intergenerational Equity

As discussed above, volatile solvency funding results in volatile benefit patterns. Volatile benefit patterns in turn result in the effective transfer of monies from one generation of members/beneficiaries to another.

For example, if the plan has to over-fund currently because of solvency funding requirements, current benefits will be set too low, unfairly resulting in the effective transfer of monies from the current generation to future generations.

Focus on Long-Term Best Interest of the Plan and its Members

MEPPs' funding focus and philosophy is normally on the long-term – as represented by a going-concern funding valuation – plan continuation scenario. Solvency funding would impose an immediate short-term (wind-up) focus, at the expense of the long-term best interest of the plan and its members.

Stated a different way: Members prefer a 99.9% probability of a higher benefit rather than a 100% guarantee of a lower benefit. Who is the government – the politicians and the regulators – to tell them (all the major stakeholders – unions, employers, and trustees) otherwise? Clearly, the

broader long-term best interest of the plan and its members must not be sacrificed for the narrow focus and short-term perspective of many regulators, and particularly in respect of an event (plan wind-up) that is virtually never going to happen.

As an analogy: The legislated speed limit on the 401 highway is currently 100 km/hr. Reducing it to 20 km/hr would clearly save lives, but yet we don't impose that....why?....because it's deemed not to be worth it (i.e. the "cost" in terms of the "few" lives lost), just as solvency funding is not worth it (i.e. the "cost" in terms of members' potential, but unlikely, loss of benefits). The difference, however, is that while reducing the speed limit to 20 km/hr would save lives and clearly be a positive result from that perspective, imposing solvency funding on MEPPs clearly has a detrimental impact on the plan and its members.

Unlikelihood of Plan Wind-Up

While I do not consider the fact that MEPPs are highly unlikely to wind-up to be a primary reason to exempt MEPPs from solvency funding, it is certainly a reality that leads to the same conclusion. The fact of the matter is that, in Ontario for example, there have been only 2 wind-ups (with a relatively small number of members) of these types of plans in the last 50 years.

Unlike the situation in respect of single-employer plans – whose future continuance is contingent on the continuing viability of a single employer – a MEPP's continuance is not dependent on the fortunes of any single employer, but rather on an entire industry (e.g. construction). Therefore, there is not the same "need" for solvency funding for MEPPs as there is for other (single-employer) plans. Furthermore, if an employer does withdraw, the affected members will typically merely move to another employer in the industry/plan.

Legal Situation

While the fundamental issue we have been dealing with above is whether or not solvency funding should be required for MEPPs, the next question is whether or not it is required in the various jurisdictions across Canada. This is a legal, rather than actuarial, issue.

The legal requirement to fund (or not to fund) solvency deficiencies varies by jurisdiction across Canada. Solvency funding is clearly required in BC, Alberta (with 3 year moratorium), Saskatchewan, Manitoba, Quebec, Newfoundland, and Federal. It is not required in Nova Scotia, New Brunswick, and PEI (no legislation). The U.S. has long recognized the differences between MEPPs and single-employer plans and has not imposed on MEPPs the solvency funding requirements applicable to single-employer plans. This position has recently been reaffirmed by their new Pension Protection Act.

While in Ontario the regulator FSCO (Financial Services Commission of Ontario) would lead one to believe that solvency funding is legally required, the reality is that it is not, nor was it ever intended to be, back when the existing legislation was introduced. After all, why are MEPPs not covered by the PBGF (Pension Benefits Guarantee Fund)? That was not an accident.

Unfortunately, however, FSCO's interpretation of the law is to require solvency funding; clarification is therefore necessary to clearly exempt MEPPs from solvency funding and avoid the continued debate. Currently, a joint taskforce comprised of industry (MEBCO) and government (political, policy, and regulatory levels) personnel is working together to define a new funding framework for MEPPs. I am confident that this framework will not involve any form of solvency funding (although the plan's wind-up position will still be calculated and disclosed, as it should be); it will, however, require strengthened member disclosure and communication, improved plan governance based on the CAPSA model (including a formal funding policy), possible restrictions on plan improvements, and benefit reductions if, on the going-concern basis, the contributions are insufficient.

Once Ontario clearly takes the position – and follows it up with legislative clarification – that solvency funding is not required for MEPPs, it is hoped that other jurisdictions in Canada and the Canadian Association of Pension Supervisory Authorities (CAPSA) will follow Ontario's lead and provide an environment across Canada in which MEPPs can thrive and continue to benefit the Canadian economy (as recently stated by the Governor of the Bank of Canada).

Summary and Conclusion

Solvency funding of MEPPs results in:

- No improvement in the security of benefits;
- Unstable contribution/benefit rates; and
- Intergenerational inequity.

Not only does solvency funding not serve any useful purpose in the case of MEPPs, it actually does harm to the plan and its members. Solvency funding is clearly not in the best interest of the plan and its members, causing potentially unnecessary benefit reductions. Most importantly, it could very well drive the plan to the point of wind-up, which is exactly what solvency funding is designed to protect against in the case of single-employer plans!

Finally, it is hoped that CAPSA will support this initiative and the legislators/regulators of the various jurisdictions in Canada requiring a change in law to exempt MEPPs from solvency funding will make those changes as soon as possible, based on: a) a clear understanding of the situation, and b) a clear recognition of the plans'/members' best interest as the top priority.

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