

DFA DALHOUSIE FACULTY ASSOCIATION

July 3, 2008

Sent by Email: lwdpolicy@gov.ns.ca

Mr. Bill Black, Chair,
Pension Review Panel,
c/o Nova Scotia Labour and Workforce Development
Policy Division
P.O. Box 697
Halifax, Nova Scotia
B3J 2T8

Dear Mr. Black:

On May 28, 2008 the Nova Scotia Government announced the review of provincial pension benefits legislation and invited commentary from those who could be affected by possible amendments to the *Pension Benefits Act*.

The Dalhousie Faculty Association (DFA), principally through the analysis provided by its Pension Advisory Committee representatives, Professors Faye Woodman, Kevin Grundy and Paul Huber, reviewed the Discussion Paper and prepared a submission that reflects the position of the DFA.

Our submission in response to the Pension Review Discussion Paper is attached and the DFA welcomes the opportunity to provide further commentary and elaboration regarding the pension discussion paper. The DFA asks that we be included in any further consultation on this issue, which is of significant importance to our Members.

Yours truly,



for David Mensink, Ph.D.
President
Dalhousie Faculty Association

DM/lap

**Response by the Dalhousie Faculty Association
To the Discussion Paper by the Nova Scotia Pension Review
Panel**

July 3, 2008

Executive Summary

The Dalhousie Faculty Association (DFA) supports the commendable goal outlined in the Discussion Paper of attempting to make pensions accessible to the majority of Nova Scotians who do not belong to one. Nevertheless it thinks that changes in the rules governing private pension plans will be unable to make a significant impact on the broader problems underlying this lack of participation. The primary concern of the Pension Benefits Act should continue to be protecting the security of the pensions of employees and retirees.

In the area of defined benefit plans the DFA challenges the Panel and commentators alike to reform their narrative of risk reduction for employers and asymmetry in pension funding. In effect, the risk of underperformance of a pension plan, which is nearly always shared between employers and employees, will be shifted to employees who are less able to bear it.

The DFA recommends fundamental changes in the governance of pension plans so that employees have an equal voice in the operation of pension plans. The participation of employees will improve governance and possibly, in the long term, decrease overall costs. The DFA recommends that the rules for surplus ownership which have been revised relatively recently remain unchanged. An important issue outside the jurisdiction of the Provincial Government is the limit imposed under the federal Income Tax Act on surplus accumulation. Representations for change should be made to the Federal Government. The response also discusses mandatory partial indexing, and reform of the system of appeals from the decisions of the Superintendent of Pensions and multi-university pension plans.

Introduction

- I. Defined Benefit Plans: Shifting the Risk to Employees
- II. Ownership of Surplus and Pension Holidays
- III. Defined Benefit Plans and the Problem of Indexation
- IV. Governance of Defined Benefit Plans
- V. Appeals from Superintendent's Decisions
- VI. Multi-Employer Plans
- VII. Selected Questions and Answers

Introduction

The Dalhousie Faculty Association (DFA) welcomes this opportunity to respond to the May 28th Discussion Paper of the Nova Scotia Pension Review Panel on behalf of over 850 faculty, librarians, instructors and professional counsellors at Dalhousie University. The DFA's members belong to the Dalhousie Pension Plan, which also includes non-faculty, including both unionized and non-unionized workers. The issues raised by the Panel in its discussion paper are important to our members and Nova Scotians generally, and are of considerable complexity. The DFA therefore regrets that the Panel has given us such a limited time period to respond to its Discussion Paper. We expect to be able to consult in person with the Panel before its final report to the Government. We also envision our participation in the full array of public hearings before any new legislation is implemented.

The Dalhousie Pension Plan is the largest of the university pension plans in Nova Scotia. It holds nearly three quarters of a billion dollars in assets. The Plan presently includes ca 2,900 active members, 140 pension deferred members and over 600 retirees. The Dalhousie Plan is a defined benefit plan but it has several unique features. Unlike most defined benefit pension plans, its assets are held in two funds: a fund for active members (the Pension Trust fund) and a fund for retired members (the Retirees Trust fund). The bifurcation of the Plan presents several unique governance issues. In particular, the division highlights the vulnerable position of retirees and other non-unionized employees under the current legislation.

The DFA notes the commendable objectives of the pension review exercise. It too supports measures to assist in the increased competitiveness and viability of business in Nova Scotia. It also shares the Government's concern about the well being of the majority of Nova Scotians who do not belong to pension plans. Measures which will implement legislative standards and improvements which will "allow pensions to work for both employers and employees" and "enhance the affordability and availability" of pensions plans are to be commended. Nevertheless, the DFA is firmly of the opinion that the first and most important objective of pension legislation has been and should be "to protect the sustainability and security of pension benefits."

It is also the DFA's view that for those Nova Scotians who are not members of pensions plans because they are self employed, not employed or members of the marginal workforce, modifications to the regulation of private pension plans are not likely to provide much assistance. Solutions lie in broader Government policies, including significant investment in educational infrastructure, and income security programs for those unable to participate in the work force due to family obligations or disability.

I. Defined Benefit Plans: Shifting the Risk to Employees

The DFA agrees with David Dodge, the former governor of the Bank of Canada, that the best type of pension plan is a defined benefit plan because it is an economically efficient way to allocate risk to those who are best able to bear it (the employers). In its Discussion Paper the Panel expresses concerns about the viability and sustainability of defined benefit plans. It notes the declining percentage of plans that are defined benefit

plans in a narrative which refers to “asymmetries” (between employees and employers) and claims that employers bear “all of the responsibility” and the “full burden” of defined pension plans. These words have a powerful impact but they serve to obfuscate, not clarify, the issues. The DFA does not accept that the Dalhousie Pension Plan, or defined benefit plans generally, imposes all the risk of making up for plan underperformance on the employer. Most obviously, employees, not employers, bear the risk of employer misadministration, malfeasance or other misadventure if a pension plan becomes unable to meet its obligations to its members. Second, even where an employer steps up its contributions to make up plan deficiencies, the cost is often an indirect employee cost. Pensions are risk sharing arrangements, and the employer and employee negotiate the formula for employer contributions. If employees accept lower current salaries for improved pension benefits, the new money entering the plan in the form of higher employer contributions is arguably paid for by these lower salaries.

Retirees of a defined benefit plan also share in the risk of underperformance of the plan because of their exposure to the risk of inflation. The Dalhousie Plan, for example, is only partially indexed. Current indexing depends on plan return in the year that exceeds 5.05%. Catch up indexing is at the discretion of the trustees of the Retirees Trust Fund and cannot exceed one half of the surplus. In times of even moderate inflation, failure to index fully can impact significantly on the value of retirees’ pensions. Presently, Dalhousie retirees share in the Dalhousie Pension Plan underperformance to the tune of a nearly 7% reduction in the value of their pensions (i.e. indexing is 7% behind). In times of high inflation, such as the last oil crisis, failure to index fully can result in a devastating reduction in the standard of living of retirees. Even today, some defined benefit pension plans offer no indexing at all. Thus retirees may face impoverishment even after a lifetime of work and contributions to a pension plan.

It should be noted that at Dalhousie a terminating employee is permitted to receive twice employee contributions plus interest. The “interest” amount is based on actual Plan return so terminating employees are subject to the risk of plan underperformance.

Finally, it should be noted that on a wind up of a plan, there is no requirement for indexing pension benefits under the provincial *Pension Benefits Act*.

The DFA recommends that

- **the rhetoric of risk be changed to recognize that the risk of defined benefit plan underperformance is shouldered both by employers and employees; and**
- **changes to the *Pension Benefits Act* should not impose more risk on employees who are least able to bear it, and who do not have the expertise, knowledge, and resources of employers.**

II. Ownership of Surplus and Pension Holidays

Part of the concern over the “asymmetry” referred to above rests on a particular view of the nature of the surplus arising in plans. If one does not accept that the employer bears all the risk, then there is no compelling reason for the employer to be able to access surplus unless the provisions of the pension plan provide otherwise. In any case, the appropriation of surplus is now regulated under the *Nova Scotia Pension Benefits Act*. It provides that in order for an employer to withdraw surplus (up to a defined amount) while the pension plan continues in existence, the terms of the pension plan must provide for the withdrawal by the employer or the Superintendent must otherwise be satisfied that the employer is entitled to withdraw the surplus. There is also a similar provision regarding the withdrawal of surplus on the wind up of a plan. In our view these provisions need no revision. In any case, assuming there are no protections embedded in an applicable collective agreement between the plan sponsor and members, the plan sponsor can indirectly access surplus by taking a contribution holiday. We propose below, however, that pension contribution holidays be regulated.

The *Nova Scotia Pension Benefits Act* does not regulate the timing and amount of pension holidays. It is noteworthy, though, that the *Income Tax Act* provides that an employer must cease contributing to a plan in which the surplus exceeds 10% of liabilities. The 10% limit has affected the Dalhousie Pension Plan. Contribution holidays for the employer and employees under the Plan (and Plan improvements) have twice been negotiated in order for the Plan to comply with the 10% maximum. The result, however, has been to exacerbate Plan deficits on subsequent market downturns. In order to prevent this sequence of events in the future, the federally imposed 10% limit needs urgent reconsideration. The Panel should recommend representations to the Federal Government. Possible solutions to the problem might include either a higher limit or some method of averaging to eliminate the volatility of the calculation.

In conjunction with changes to the federally imposed limit, the Panel should consider measures which would limit the taking of pension contribution holidays to ensure an adequate level of surplus remains and to ensure that the holidays end in a timely manner when conditions change.

The DFA therefore recommends that

- **representations be made to the Federal Government to change the 10% of liabilities limit imposed under the *Income Tax Act* on the amount of surplus that may be retained in defined benefit plans; and**
- **the *Pension Benefits Act* be amended to ensure that an adequate level of surplus remains in the Plan and that contribution holidays end in a timely manner when conditions change.**

III. Defined Benefit Plans and the Problem of Indexation

The *Pension Benefits Act* does not require benefits under a defined benefit plan to be indexed. We have already referred to the difficulties that can ensue for retirees who belong to unindexed plans. We note the suggestions in the Discussion Paper that pertain to defined contribution plans. We understand the cost of indexing benefits under any type of pension plan may be considerable. However, we think the issue is so important that we recommend the Panel consider methods to introduce partial mandatory indexing of pension plans.

The DFA recommends that

- the Panel consider methods to introduce partial mandatory indexing of pension plans.

IV. Governance of Defined Benefit Plans

Currently the *Pension Benefits Act* does not provide for employees in Nova Scotia to have an effective voice in the administration and investment policies of their defined benefit plan. To some extent this situation reflects the paternalism and class bias of an earlier era. It is an attitude which has been more or less accepted in the legislation governing pension plans in other Canadian jurisdictions. Fortunately, change is slowly occurring, and employees are demanding and getting more of a voice in their pension affairs. Since for many employees near retirement their pensions are their biggest or second biggest asset, this change is past due. In any other sphere of economic life, it is hard to imagine “owners” being so powerless.

In our view, and it is a view adopted at least in part by the Courts, pension benefits are deferred wages and are part of the total compensation package of workers. In many instances, such as at Dalhousie, workers ranging from janitors to faculty members have struck an implicit bargain with the employer under which current wages are traded off for, among other things, future retirement security. This bargain continues throughout the work life of the employee. While retirement security may not be a significant motivation for new young employees, over time it may serve to increase the employee’s attachment to Dalhousie, especially in an increasingly competitive market for qualified faculty.

There is another reason for change. It is that equal employee participation in pension plan governance will be a natural check and protection against plan default or underperformance. The oversight of self-interested employees and their advisors will ensure, among other things, more transparency and possibly fewer conflicts of interest in plan administration.

The Nova Scotia *Pension Benefits Act* provides for an Advisory Committee which, as the name implies, is only advisory. One benefit, however, is that the administrator of the pension plan must provide “such information as is under the control of the administrator and is required by the advisory committee or its representative for the purpose of the committee.” At Dalhousie, an Advisory Committee has not been

established. The Pension Advisory Committee established under the specific provisions of the Dalhousie Pension Plan is an employer/employee parity committee with voting representatives from unionized groups. Management employees do not have a vote, and neither do retirees. The DFA and the NSGEU also have veto powers over amendments to the plan pursuant to their respective collective agreements.

The Actuary

It is noteworthy that the Act also provides rules governing the exercise by the administrator and its employees or agents of their duties. The rules proscribe conflicts of interest between the administrator's interests (including those of the administrator's employees and agents) and its respective duties and obligations to the plan. The lack of specificity in the rules has engendered controversy regarding the role, in particular, of the actuary at Dalhousie. The actuary is a person of signal importance in the plan and the view of the employee groups has been that the actuary should be an independent purveyor of information and advice to the administrator and the Dalhousie Pension Advisory Committee. In this regard, it is hard to overstate the importance of the actuary. The actuary plays a fundamental role in which he/she elucidates the financial parameters within which the plan must operate. Not only does the actuary provide expert interpretations of the data, but, understandably, he/she also has privileged access to it. The actuary, who usually has experience with other plans, provides a range of possible alternatives for the resolution of various problems. Practically, effective action is constrained by the alternatives put forth; thus, virtually no action is taken in the plan without the actuary's input.

Regrettably, the legislation does not deal specifically with the position of the actuary. Although many aspects of the actuary's role within the pension plan are governed by the actuary's professional code of conduct and by the laws of equity regarding fiduciary relationships, there is considerable ambiguity surrounding the nature and extent of the actuary's activities.

The DFA recommends that

- **the fiduciary nature of the actuary's role in advising a pension plan be more clearly delineated in the *Pension Benefits Act* and specific rules be implemented regarding conflicts of interest.**

The Trustees

In the Dalhousie Pension Plan, funds are placed in the Pension Trust fund or Retirees Trust Fund. Separate sets of trustees manage the investments of each fund. Although an argument may be made that the actions of the Trustees, to some extent, should be overseen by the Pension Advisory Committee, in practice the Committee has not exercised any significant oversight. The Trustees must comply with the terms of the trust indenture, and the laws of equity govern the exercise of their powers. Among other things, the trustees of the Retirees Trust Fund have the right to determine in their

discretion whether to provide catch-up indexing for retirees to an amount not exceeding one half of the surplus.

Most of the trustees are not lawyers, and it has become apparent over time that many of them may not fully appreciate the nature and extent of their fiduciary obligations to the beneficiaries of the funds, i.e. plan members. The complexity of the position and the duties and obligations of trustees should be clarified with specific provisions in the *Pension Benefits Act* outlining in accessible language their duties. It should be clear that the trustees are not mere appointees of the administrator but independent actors with important responsibilities to fulfill.

The DFA recommends that

- **the nature of the trustees' obligations be set out in the *Pensions Benefits Act*.**

V. Appeals from Superintendent's Decisions

Under the *Pension Benefits Act* the Superintendent sits on appeals from her own decisions. This is problematic. Not unexpectedly, the Superintendent is not apt to overrule herself. Appeals can then be made from the Superintendent's decision to the Nova Scotia Supreme Court.

It is possible that the establishment of a Pension Appeal Tribunal would facilitate appeals and reduce expenses since the initial appeal would not be to a Court and the Tribunal would have an expert Chair.

The DFA recommends that

- **consideration be given to the establishment of a Pension Appeal Tribunal. It should be comprised of three members. The Chair should have expertise in pension law. An appeal of the Tribunal to the Nova Scotia Supreme Court should be made on a reasonableness standard.**

VI. Multi-Employer Plans

The DFA is opposed to the establishment of a compulsory multi-employer plan for universities. The benefits for employees and retirees of membership in a multi-employer plan will vary from university to university. In some universities a majority of the employees and retirees may see the merit of joining such a plan. In every case, however, the university pension plan, like the Plan at Dalhousie, represents years of negotiations between the employer and employees and substantial mutual trade offs. Any changes to a university's pension plan without consultation and agreement would disrupt this balance and might unfairly strip employees and retirees of hard won benefits.

VII. Selected Questions and Answers.

Reproduced below is a selection of questions raised in the Discussion Paper. We have not addressed them all because of the limited time we have had to reply. We have chosen to respond to the questions that are directly relevant.

Section 3

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

The DFA thinks the goal of pension regulation should primarily be to safeguard employee entitlements to benefits promised under pension plans. The protection of individuals' private property rights is a fundamental role of government.

Section 4.1

Should the current trend toward less DB plans be accepted or should regulators permit DB plans that may be more attractive to employers by reducing funding risks?

The market will eventually determine the ascendancy of either type of plan. The DFA is of the view that defined benefit plans are the best type of plans for employees since the employer, not the employee, is in the best position to shoulder the majority of the risk. It does not accept, however, that in every case the operation of a defined benefit plan necessarily means the employer is in fact bearing all of the risk.

Section 4.2

Are current rules for measuring and remediation of going concern and solvency deficits appropriate?

The DFA thinks that these rules are generally appropriate to protect employees.

Should there be exceptions to the funding rules for universities, multi-employer pension plans and municipalities or anyone else?

The DFA recognizes that there have been exceptions made for universities in other jurisdictions. The DFA supports flexibility on the part of the government, such as the flexibility exhibited in the recent short accommodation for universities with solvency deficits.

Until the DFA sees more discussion, it is not prepared at this time to support total elimination of the solvency test for universities.

Should going concern funding still be a requirement?

The DFA supports the going concern funding requirement in conjunction with the solvency requirement as being the most accurate gauge of the appropriate funding requirements of a pension plan.

Should promises as to future benefit accrual be restricted to the level that can be funded by current contributions?

If future benefits are restricted to the level that can be funded by current contributions, then the defined benefit plan practically becomes a defined contribution plan or hybrid.

Should there be a requirement for full funding at winding up?

The DFA would like to see a more detailed proposal and some estimates of the cost to pension plans of any change in the legislation, especially regarding the funding of indexation.

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 plan?

The DFA's position is reflected in section VI of this response.

Section 4.3

Should regulators speak to the question of the ownership of the plan surpluses? If so, what should it say?

The DFA's position is that the surplus issue has already been resolved by the existing provisions in the *Pension Benefits Act* and there should be no change.

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 the entitlement to surplus?

The DFA's position is that pension entitlements are deferred wages. See section II on ownership of surplus.

Section 4.5

Should government attempt to define, audit, and regulate "good governance?" Why or why not? If so, what types of governance issues should be regulated?

The DFA's position is that the *Pension Benefits Act* should define the most important parameters of good governance. In particular, the Act should outline the fiduciary duties of the actuary and trustees and specify situations in which there is a conflict of interest. See section IV of this response.

Given that there are associated costs with governance, what is the appropriate cost for “good governance?”

The DFA points out that there are many and heavy associated costs of bad governance which must be borne by government, employers and employees. It views employee participation as a way to reduce these costs in the long run.

Section 4.7

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?

Though the idea of streamlining and reduction of regulation is attractive, the experience of professionals in the income tax field is that there is a trade-off between equity and simplicity. In the case of pensions there may be other trade-offs such as the protection of employees. See section V for comments on the appeal process.

Section 4.9

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

The DFA regrets that it has not had enough time to consult with its members on this controversial and difficult question.

Section 4.3

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

Pension funds and TFSAs are fundamentally different savings vehicles. Employers and employees can deduct amounts they contribute to a pension plan. (Universities are generally tax exempt so the employer side is not applicable.) On the other hand, no person can claim a deduction for a contribution to a TFSA. Thus the blending of the two types of savings vehicles is likely to be difficult from a tax perspective.

It seems inequitable that income received from a TFSA will not reduce certain government entitlements while income received from a pension plan will. The difficulty may lie in the nature of the TFSA itself but that discussion is beyond the ambit of this response.