A SUBMISSION TO THE

Nova Scotia Pension Review Panel

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INTRODUCTION

We would like to thank you for providing us with the opportunity to submit a response to the Nova Scotia Pension Review Panel. We wish to commend the government of Nova Scotia for sponsoring this important initiative and offering a process to review regulation of pension plans with the goal of an improved pension system for all. This submission represents the views of its signatories, who are actuaries and active pension practitioners with Eckler Ltd. of Halifax. It does not necessarily represent the views of other practitioners in our firm.

The following provides a brief overview of Eckler Ltd. and the format in which we have prepared our response to the panel's Discussion Paper.

Founded in 1927, Eckler is one of Canada's preeminent actuarial consulting practices. The firm has offices in six cities in Canada (as well as two in the Caribbean) and employs over 70 Fellows of the Canadian Institute of Actuaries. Owned entirely by our 32 principals, all of whom are active, consultants, we regard ourselves as a preeminent company; we are the largest independent Canadian-owned actuarial consulting firm.

Our size gives us the advantage of being large enough to provide a wide spectrum of actuarial and benefits advice, as well as to stay up-to-date in our use of technology, yet still small enough to provide prompt and attentive service. We provide traditional actuarial and benefits consulting services, covering all aspects of design, pricing and advice in respect of pension plans. We provide third party administration services, including record keeping, year-end statements, and processing of terminations, deaths and retirements; for larger clients we provide custom-designed pension administration systems. We also provide non-pension actuarial consulting services in the areas of Workers Compensation, disability plans, and the valuation of post-retirement non-pension employee benefits. In Halifax, we have a total of 12 staff members, five of whom are Fellows of the Canadian Institute of Actuaries. Our staff also includes pension administration staff, actuarial staff, investment consulting staff and computer programming personnel.

We recognize that the panel has a large volume of information to review with this process. Accordingly, the format of our submission to the panel is intentionally brief and reasonably direct. We have structured our response in a question and answer format, reproducing the questions directly from the panel's document with our response immediately following each question. We would be very happy to expand in greater depth on any of the discussion points that you are intrigued with at your convenience.

Respectfully submitted,

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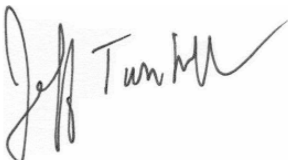

Jeff Turnbull, FSA, FCIA

Jeff Clark, FSA, FCIA

July 4, 2008

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PENSION REVIEW PANEL: DISCUSSION PAPER QUESTIONS

Section 3. Pension Plan Legislation, pg. 8

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

We support the goals listed, and would add that another goal would be to promote the growth and sustainability of pension plans. Pension plans are voluntary arrangements, and pension legislation should not be so onerous that it becomes a deterrent to their creation or sustainability.

Section 3.1 Types of Plans, pg. 9

Question:
Are there plan designs not in use that would provide the benefits of DB plans while minimizing risk?

Yes. We refer you to a submission made to the Ontario Commission that we have attached as a link to this submission. http://www.pensionreview.on.ca/english/submissions/Eckler.html

In the submission to the Ontario Commission, we outline some of the concerns and challenges that have been raised within the current framework under which pensions are usually provided through a traditional DB pension plan or a traditional DC pension plan.

We then go on to outline how a Target Benefit plan design could be used to redefine the "pension deal" and result in a method of sharing risk that may be more appealing to some employers and employee groups. We believe that this model would offer employers and employees a middle ground for sharing the risks associated with pension plans, as an alternative to the two extremes currently offered by pure DB and DC.

From the employer's perspective, this type of arrangement would provide greater cost certainty from both a cash contribution and an accounting perspective. We believe the lack of this type of certainty has been, and will continue to be, a significant factor in the demise of the traditional DB plan.

Other features of a Target Benefit plan would also be attractive to plan sponsors and employees. Traditionally, DB plan have acted as an important Human Resources tool, enabling the transition into retirement of employees through the provision of adequate pensions. Under a Target Benefit plan, the benefits are still determined based upon a defined formula, which allows all parties to the pension deal to monitor benefit adequacy and to consider upgrades to the formula when affordable.

There are many employee groups for whom the DC plan model may be determined to be unsuitable. This may be for various reasons, which are well documented in pension literature. A Target Benefit plan offers shared governance and oversight, a pooling of certain risks, and a clearer understanding of surplus and funding responsibilities. We believe that this would be a suitable alternative to the traditional DB plan for many employee groups.

Section 4.1 Defined Benefit (DB) Plans versus Defined Contribution (DC) Plans, pg. 12

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?

Regulators should permit DB plans that are more attractive to employers. This can be accomplished by adding new types of pension plan deals (see above) and by improving the current DB regime, by seeking ways to make the regulations less onerous. In particular, we believe DB plans would be more attractive if the regulations can be changed to reduce the volatility of funding requirements, and by providing a framework that respects the ability of plan sponsors and employees to determine a pension deal that suits their own particular needs.

The trend towards fewer DB plans would not necessarily be problematic if it was the result of plan sponsors and employees choosing, from among various pension deals available, the one that suits their particular needs and characteristics. For some groups, a pure DC plan makes sense. For others a pure DB plan would be most appropriate. We believe that the current environment under which DB plans operate make them sufficiently unappealing to plan sponsors that some are rejecting that plan design, even where it may have been the most sensible design for their employees.

In the case of DC plans, to what extent should an employee's right to make investment choices be limited, and by whom?

Regulators should not limit choices or this will merely make group RRSP's a more attractive choice than DC plans. The plan sponsor should be permitted to limit choices as they currently bear some responsibility for education of plan members, monitoring investment choices and the performance of investment managers.

Regulators may play a role in defining a minimum number and type of investment choices, and in defining default investment choices for plan members who do not make an election. This would provide plan sponsors with "Safe Harbour" protection from litigation. Nova Scotia's regulations should be consistent with other jurisdictions in this regard.

Should new forms of DB pension plans be permitted to enhance their availability?

Yes. See above for comments regarding a Target Benefit Plan design.

Should new forms of Hybrid pension plans be permitted to enhance their availability?

Yes, we are in favor of permitting additional flexibility that respects the ability of plan sponsors and employees to determine a pension deal that suits their own particular needs.

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?

Yes, we would be supportive of providing DC members with more flexibility by choosing a LIF type payment option. However, there would be challenges with any proposal that went as far as permitting a DC plan to self-insure their annuities.

Section 4.2 Pension Plan Funding, pg. 15

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

We are supportive of the view that provincial regulations should prescribe a minimum level of funding that is required for a pension plan. A plan sponsor can determine a funding policy that satisfies the minimum standards, but that further reflects its needs and goals, the nature of the pension deal, the ability to access surplus, and its ability to tolerate fluctuations in its funding requirements.

Currently, Nova Scotia's regulations prescribe both a going concern valuation and a solvency valuation to determine minimum funding requirements. Both are useful in assessing the financial health of a pension plan. Unfortunately, there are issues with each type of valuation when it comes to determining minimum funding.

The main problem with using a going concern valuation to determine minimum funding lies in the fact that it is not well defined. Different actuaries may legitimately select different assumptions or cost methods to value the liabilities of a plan on a going concern basis. That is fine in the context of a plan sponsor choosing its funding strategy, but perhaps unacceptable when determining legislated minimum funding.

Solvency valuations are intended to give the regulator a measure of how well funded certain pension benefits would be on wind up. Current regulations provide reasonably detailed instructions on how to calculate solvency liabilities. However, current regulations provide plan sponsors and actuaries with the option to smooth the assets. Further, for some pension plans, the solvency liabilities are equal to what the actual wind-up liabilities would be, whereas for other pension plans they are not, due to the exclusions permitted under regulations. This results in an inconsistent measure from plan to plan.

If solvency and going concern valuations are to be used to determine a minimum level of funding, we believe it necessary to clearly define the measures, so that they truly measure what is intended, and there is no ambiguity in the results.

Having properly defined a valuation method (or methods) for use in determining minimum funding requirements, the question then becomes one of determining what the minimum contributions will be. There are two aspects to this: the current service cost; and the amortization of any deficits. Aside from observing that an appropriately defined minimum current service cost contribution should be set out in the regulations, for purposes of this submission, we will focus our remaining comments on the aspect of amortizing deficits.

To begin, we support the concept that there are different levels of risk associated with different pension arrangements. We believe that this has been recognized in the past where exemptions to solvency funding have been granted for universities, municipalities, and multi-employer pension plans.

For a single private sector employer, there is a risk of the plan sponsor becoming insolvent and leaving the pension plan in a deficit position. This can legitimately result in minimum funding requirements that are more heavily influenced by the short-term solvency position of the pension plan.

Plan sponsors have been struggling with the current solvency funding requirements. At the risk of over simplifying, the concerns lie in the volatility of funding requirements introduced by the marking-to-market of the liabilities, combined with the relatively short period allowed for remediation of funding short falls. In many cases, there is an additional concern that the accelerated funding associated with solvency shortfalls will someday find its way into plan surplus. The implication of such a circumstance is that, with the benefit of hindsight, the accelerated funding was unnecessary; unfortunately, at this point, it is, for all practical purposes, lost to the funder. We recognize that there is a delicate balance between the goal of benefit security and the sustainability of DB pensions in the long-term, and it will be a matter of public policy to determine the point at which sustainability is effectively sacrificed in the name of benefit security.

In considering this balance, the following is a list of possible considerations with regard to deficit funding that could alleviate some of the challenges faced by plan sponsors:

1. **Volatility Challenges** It may be appropriate to develop amortization schedules that vary depending upon the degree of funding. This would give more flexibility to a plan sponsor whose pension plan temporarily dips into a deficit position, but as the problem worsens, less flexibility is offered. For example, solvency deficits of 5% might be funded over 15 years, the next 5% of deficit might be funded over 10 years, and anything else would be funded over 5 years.
2. **Risk Profiling** With respect to point 1 above, the amortization periods and/or percentage breakpoints could vary between pension plans based on certain risk characteristics such as the maturity of a plan (perhaps measured as a percentage of liabilities with respect to members over age 55) or asset/liability mismatch. The purpose here would be to reward prudent risk management practices.
3. **Cash Budgeting** Funding requirements begin effective to the date of the actuarial valuation. The reality is that actuarial valuations are often not completed and filed until several months have passed. Once filed, a plan sponsor can be faced with the prospect of making large payments retroactive to the effective date of the valuation. Permitting amortization to begin once the report is filed would offer some relief to plan sponsor’s budgeting concerns. It would be a simple exercise for an actuary to include an interest adjustment to the amortization to reflect the delayed commencement of amortization.
4. **Cash Budgeting** The current triennial valuation system can result in an unnecessarily hefty burden on plan sponsors if solvency amortizations overlap. For instance there can be 2 years remaining on a prior solvency deficiency when a new solvency deficiency arises. The new deficiency must be amortized by level payments over 5 years, so there will be two years of overlap at a very high contribution level. A system that permitted back-ending the amortization of the second deficiency in order to provide a new level 5-year amortization schedule would be helpful. We note that this problem is a manifestation of the current regulations, and that it may be alleviated if some of our other suggestions are implemented.

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

The characteristic that potentially distinguishes municipalities and universities (and potentially others, for example certain regulated utilities) is the arguably minimal risk of default on member benefits. We believe that it is appropriate to take this into consideration when determining an appropriate minimum funding regime.

We believe the remediation for Target Benefit plans, including SMEPPs, should also be different, as outlined elsewhere in our submission.

Should going concern funding still be a requirement?

We believe that a going concern valuation plays an important role in a plan sponsor setting its funding targets. If a “going concern” type valuation is to play a dominant role in defining an “alternative minimum funding standard”, then we believe it would be necessary for regulations to further define what that alternative standard is.

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

No response.

Should there be a requirement for full funding at wind-up?

Yes, depending upon the nature of the pension deal. A traditional DB plan should be fully funded. For other types of plans, such as Specified Multi-Employer Plans or Target Benefit Plans, where the plan sponsor's obligation is only to make the required contribution, full funding would not be a requirement.

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?

We believe that there is potential for a province wide pension plan that operated under either a DC model or a Target Benefit multi-employer plan.

Section 4.3 Surpluses, pg. 16

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

Pension legislation should permit plan sponsors and members to develop and articulate their own surplus rules within the pension plan text.

While many would welcome a legislated solution to the current uncertainties that exist within many pension plans with regard to surplus ownership, we question whether such a solution is possible. If not, then we would be in favor of the regulator stepping back and not imposing any rules or restrictions on the use of surplus. Entitlement to surplus would then truly be a matter to be determined by reference to the supporting plan documentation.

In such a scenario, we would envision the regulator's role to be one of ensuring that an appropriate communication is issued to plan members and stakeholders. For example, an employer could withdraw surplus only if the plan documents allowed for such withdrawal, and only after sufficient notice is given to all stakeholders. The regulator would not attempt to rule on the legality of the withdrawal. The regulator would approve the withdrawal only after an appropriate time has elapsed since notice was given. An appropriate period of time would be necessary to permit plan members and other stakeholders to consider the merits of challenging the employer's right to the surplus.

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?

The concept of "deferred wages" can be a valid component of an overall determination for entitlement to surplus. However, further to our answer to the previous question we believe that the regulator's role is to ensure compliance with plan documentation and appropriate disclosures are made to plan members.

Section 4.4 Multi-Employer Pension Plans, pg. 18

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?

A distinction needs to be made between multi-employer plans and *specified* multi-employer plans, where the former may be loosely defined as being a common plan for a group of related (non-arm's length) entities, and the latter may be defined as they are in the Income Tax Act. Specified multi-employer plans are, to some extent, a subset of the Target Benefit plan alluded to earlier in our submission, and we would contend that the Target Benefit plan is, in fact, an ideal design in a multi-employer context.

With respect to specified multi-employer plans, we do not believe the hybrid solution is appropriate. These plans, at least those in Nova Scotia, struggle when faced with the single-employer plan remedies to solvency problems; such remedies do not a fit with, and largely detract from, the specified multi-employer plan model.

Which of the funding tests should apply to MEPPs?

Specified multi-employer plans are unaffected by the demise of a single participating employer, or even, potentially, a group of employers. As such, their time horizon is legitimately “longer term” – the expected average remaining service life of a current group of actively contributing members can, for example, be in excess of 15 or even 20 years. As such, while we are supportive of a regulated minimum funding standard, we believe it is closer to a traditional “going concern” standard than the current solvency standard.

Should regulators facilitate the further development of hybrid plans? Would the Quebec model be an attractive option for Nova Scotia employers?

Please see prior comments regarding Target Benefit plans. We note that the Quebec member-funded plans do not fit with our Target Benefit plan concept because of the inability to reduce benefits.

Section 4.5 Governance, pg. 19

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

We are very much in favor of encouraging good governance. However, we do not feel additional regulation should be added.

Current legislation already imposes a certain level of “good governance” in various forms such as minimum communication, reporting, investments, administration and funding. Further attempts to impose additional layers of “good governance” would run the risk of over-regulating and discouraging pension plans.

There are many sources for plan sponsors to access information and ideas on good governance and to implement procedures that are best suited to their particular situation.

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

No response.

Section 4.7 Role of Regulators, pg.20

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?

For the most part, we believe the regulatory system works effectively.

Consideration could be given to defining separate regulations that reflect the unique circumstances that exist for certain categories of pension plans such as DC, MEPPs, Small DB, Large DB, Designated Plans, and different types of pension deals. Many of our answers given in this submission have reflected distinctions that may legitimately be made between different types of pension plans.

We would suggest consideration be given to removal of the partial wind-up concept. First, we note that on plan wind-up, a member's entitlement is currently impacted in three main ways: immediate vesting; grow-in; and the potential for surplus sharing. With current two-year vesting rules in place, immediate vesting is of minor significance. As mentioned elsewhere in our submission, we advocate for the removal of grow-in requirements on wind-up. Finally, we do not believe that it is appropriate in an ongoing pension plan to crystallize and distribute a surplus that existed at a specific point in time.

Consideration should be given to the removal of the requirement on plan wind up to purchase a deferred annuity. There are simply too many options to price, and the insurance market is not robust enough to make it a reasonably priced option. Members should be given the right to purchase an immediate annuity, or transfer the commuted value.

If the regulations do not address a situation that should not automatically mean it is not permissible.

Should a plan have a minimum number of members before the government will regulate it? If so, what minimum number of member would be appropriate?

No, but regulations should not be so cumbersome that small employers are discouraged. See comment above about having separate regulations for different types of plan.

Section 4.9 Unlocking Funds, pg.22

Question:
To what extent should regulators attempt to regulate an employee's right to access funds?

We support the current locking-in provisions.

Consideration could be given to raising the small pension threshold higher than the current rules.

Section 4.10 Grow-in Benefits, pg. 23

Questions:
Should the legislation require grow-in benefits to be provided on plan wind-up?

As a principle, regulations should focus on accrued benefits that have been earned to date at the time of wind-up. The notion of grow-in is inconsistent with this principle. We offer the following points for consideration:

- Grow-in is not required in most other jurisdictions. Regulatory consistency across provinces should be a goal, so as not to put Nova Scotia at a competitive disadvantage.
- Mandatory grow-in will act as a deterrent against plan provisions which are intended to reward long-service employees once they have attained specified age and service qualifications. We fear that requiring grow-in benefits will ultimately lead to the removal of benefits from DB plans that would otherwise be judged to be beneficial.
- Grow-in could be included voluntarily in the pension plan if plan sponsors and employees agreed.

Should legislators maintain the requirement to fund grow-in benefits upon wind-up?

As stated above, we believe that grow-in is inconsistent with focusing on accrued benefits to the date of wind-up.

Section 5.1 “Safe Harbour” Rules, pg. 23

Question:
Should “safe harbour” rules be established that would give DC plan sponsors and administrators protection from litigation?

Yes

Section 5.2 Phased Retirement, pg. 23

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

We support the addition of options such as phased retirement that plan sponsors could add to their pension plans in order to best meet the needs of their plan members. Nova Scotia’s regulations should be consistent with other jurisdictions, and should not be too cumbersome to the point that they discourage the benefits that are being regulated.

Section 5.3 Tax Free Savings Accounts, pg. 24

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

None.