Watson Wyatt's Submission
to the
Nova Scotia Pension Review Panel

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Watson Wyatt's Submission to the Nova Scotia Pension Review Panel

Introduction

The creation of the Nova Scotia Pension Review Panel (Panel) comes as welcome news to many pension plan sponsors. The sustainability and continued viability of defined benefit (DB) pension plans has been the topic of much discussion over the last several years, both within the financial community and in the public at large. In addition, court decisions and strains on pension plan funding have clearly signaled the need to re-examine the Nova Scotia *Pension Benefits Act* (PBA), associated regulations and regulatory system.

Watson Wyatt assists many plan sponsors with the planning and administration of their pension plans. We are one of the largest retirement, actuarial and human resources consulting firms in the world and have the honour of being the first in our field, tracing our roots back to 1870. We are the leading actuarial provider to the world's largest pension plans.

Our submission is focused on the questions in the Panel's Discussion Paper, from the perspective of sponsors of single-employer DB and/or defined contribution (DC) pension plans.

Pension Plan Legislation

Should pension legislation and regulation have goals other than those listed in the Discussion Paper?

We believe that the goals of pension legislation and regulation listed in the Discussion Paper are suitable goals for such legislation and that as such they are commendable. However, we also believe that they should include the goal of promoting and expanding occupational pension plan coverage. This should be done by adopting measures that facilitate future pension accruals, balanced by the need for reasonable security of accrued pension benefits. We believe this can best be accomplished through the implementation of more flexible funding rules, accompanied by clearer communication of the risk-sharing deal to stakeholders.

The current legislative and regulatory environment hinders the establishment or continuation of DB plans. Such plans are long-term financial commitments, which require long-term planning. We believe that the goal of pension reform in Nova Scotia and throughout Canada should be to reflect the reality of DB pension plans, and support their continued development and expansion. DB pension plans can, and do, provide a level of security of income throughout retirement that cannot be matched by private savings, RRSPs or DC pension plans. DB plans can also deliver benefits with greater efficiency than private savings, RRSPs and DC pension plans.

Unfortunately the situation has been allowed to develop in Canada, whereby constraints are placed on design, operation and management that severely limit the ability of employers to manage a DB plan with an acceptable level of risk, costs and expenses. Multiple parties have contributed to these constraints, including legislators, regulators, the courts, the Canada Revenue Agency (CRA), the Canadian Institute of Actuaries (CIA) and Canadian and international accounting standards boards.

For all products and services, there is a balance to be struck between performance and risk. DB plans, like DC plans, expose both sponsors and members to risks. However, we believe that such risks can be managed without undue loss of performance. We also believe that managing risk is not the same as eliminating risk. For example, when you purchase a major appliance, you have the option of purchasing an extended warranty program. However, this extra protection is not free, and most individuals would rather put their money towards a better appliance.

For pension plans, the balance is between the investment returns needed to create adequate expected benefit levels and the reliability needed for plan members and employers to feel confident in their plan. Experience shows us that the alternative to a DB plan is either no coverage at all or coverage with lower contributions and lower efficiency, backed by more conservative investments that deliver lower benefit levels and less predictable retirement income.

Employees, employers, and governments have all benefited greatly from the practice of providing defined benefits financed by diversified investment funds. Because of anticipated investment gains, some groups of employees have been covered when they otherwise might not have been. Others have been offered better benefits. As a result of realized investment gains, many employees, both active and retired, have had their benefits improved using the investment surplus generated. Many employers have benefited from contribution holidays taken using surplus generated from realized investment gains. Governments have benefited from reduced calls on support programs such as GIS because employees have received better coverage and better benefits.

Benefits in Canada have also been surprisingly reliable. Despite the significant stresses to funding resulting from the perfect storm in 2001 and 2002, most pension plans have not decreased benefits at all. Moreover, DB pension benefits have greatly increased in value in this time of low inflation, low interest rates, and increasing longevity. Conversely, these same phenomena result in lower relative benefits from private savings, RRSPs, or DC pension plans. We suspect that those relatively few members who have suffered a partial loss of DB benefits would have received even lower benefits if the plans had originally been financed using insurance contracts or bond-only portfolios. At one time, provision of pension benefits by purchasing deferred life annuities was commonplace. Such arrangements were phased out primarily because the benefits delivered by such arrangements were appallingly low in relation to the contributions that had been paid.

While we would all like to maximize security of benefits, the financial reality is that any legislation that attempts to further increase the security of members will likely hasten the demise of voluntary pension plans. This essentially provides additional security for today's plan members at the expense of tomorrow's members.

A wide gulf has developed between those employers who voluntarily sponsor DB plans and those who do not. DB plan sponsors are finding they are exposed to greater risks and expense than they originally contemplated, yet must still compete for business, staff, and capital in highly competitive market places. Legislation has played a significant part in aggravating that difference, both in terms of risk and expense.

Plan sponsors, with the help of their advisors, need to readdress the issues of performance versus risk, and of level of intended benefits versus reliability of delivery. Plan sponsors need to be willing to adjust plan terms to keep cost and risk within a manageable range. Realistically, the result of such deliberations may well be a reduction in the ratio of guaranteed benefits to contributions. Members must be prepared to accept this as a quid pro quo for greater security and the potential for future benefit upgrades if investment strategies are successful. Changes in legislation that fail to balance security with coverage and benefit levels will severely inhibit such efforts. Changes in legislation that do balance these issues are a necessary precondition to the widespread success of such efforts.

Types of Plans

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

We believe that pension legislation should facilitate the development and maintenance of a number of different plan designs, but should ultimately reflect the proposition that responsibility follows risk.

The current single-employer pension model in Canada makes employers responsible for deficits and governance in continuing plans while leaving uncertainty over surplus ownership and benefit security when businesses are restructured. Employers and plan members frequently disagree over surplus entitlement, yet employers are overwhelmingly responsible for any deficits that arise. Employers have responded with minimum funding of their plans to avoid large surpluses and the resulting surplus battles, leading to underfunded plans and less benefit security for plan members.

The issue of who ultimately owns pension funds, together with the related risks and rewards, needs to be resolved definitively. The term "asymmetry" is used below and throughout our submission to describe a situation in which the employer assumes most of the risk for pension deficits in a continuing plan, while plan members claim a sizeable share of surplus distributions. The table below outlines three alternatives to the current asymmetrical model, all of which align ownership of surplus with responsibility for deficits.

	Surplus Owner	**Deficit Owner**	**Security (relative to current regime)**	**Governance**
Current Regime	Uncertain	Employer		Employer
1. **Guaranteed Funding**	Employer	Employer	Stronger	Employer
2. **Member-Sponsored Pension Plan**	Members	Members	Weaker	Members
3. **Jointly-Sponsored Pension Plan**	Shared	Shared	Comparable	Shared

Each of these alternative models shares risk and governance in a different way, but in all cases the "deal" between sponsor and members is clear. Some models will clearly work better in some situations.

1. **Employer-sponsored pension plan with employer-owned surplus and greater security for all benefits (Guaranteed Funding)**

The Guaranteed Funding model is an alternative to the current regime that would provide plan members with greater benefit security and employers with greater access to pension surplus. In this regime, ultimate ownership of pension assets, funding risks and governance would rest with the employer. In exchange, plan members have greater benefit security. Several features could be utilized to strengthen benefit security, including increased obligations for plan sponsors (and receivers and trustees in bankruptcy) to fund benefits upon plan wind-up.

Watson Wyatt conducted roundtable discussions with a number of plan sponsors to solicit their views on a range of issues in September 2007 (Roundtable). Some Roundtable participants felt that private sector companies would prefer the Guaranteed Funding model because it resolves the issue of surplus and retains employer control over investment and other governance decisions. As well, they believed that many labour groups would find it appropriate, given their concern with security of benefits.

For companies that are subject to intensive scrutiny by securities analysts and investors, there could be a downside to the Guaranteed Funding model. The increased guarantees could lead to more conservative investment strategies in order for employers to avoid the risks of an under-funded plan, because today's shareholders might not tolerate the sorts of investment risks normally assumed by DB pension plans. Conservative investment strategies make pension plans more expensive because they produce lower investment returns in the long term. In the short term, the expectation of lower investment returns leads to either higher contributions or less generous benefits being promised. In the long term, the realization of lower investment returns leads to either higher contributions or less generous benefits being paid.

2. Member-sponsored and negotiated contribution pension plan with members owning surplus, deficits and governance (Member-Sponsored Plan)

The Member Sponsored Pension Plan model is based on well-established union-sponsored multi-employer pension plans and the recently developed Quebec model of the Member Funded Pension Plan (MFPP). In 2007 Quebec introduced the concept of MFPPs whereby Quebec employees can initiate the establishment of a DB pension plan. Members of these plans are responsible for governance, and bear all the responsibility of pension plan funding, investments, costs, surplus, and deficits, if any.

The Quebec MFPP is the starting point for our concept of a Member-Sponsored Pension Plan (MSPP). From an employer perspective, these would be similar to DC plans, but they preserve many of the beneficial elements of DB plans. These include the pooling of longevity and early retirement risks, intergenerational pooling of investment risks and large investment funds with low management fees and professional oversight.

While some employers may prefer the Member-Sponsored Plan because they would not be responsible for deficits or governance, there may be concerns about the employer's residual obligation in a plan that is run by employees. If the governance committee did not manage investments appropriately, and the plan's funding suffered, employers would be concerned about possible legal liability, and the effect on employees' ability to retire when they should. In addition, this alternative might result in higher long-term benefit costs, if the members choose to follow an overly conservative investment strategy. In addition, some sponsors may believe there is misalignment between the plan design and their workforce renewal objectives and strategies

We also have some actuarial concerns about the long-term viability of Member-Sponsored Plans, since it would be difficult for members to manage a pension plan with a declining population of active employees. In this case, the declining normal contributions for active employees could not continue to absorb the risks associated with an increasingly large group of pensioners.

Negotiated contribution plans operate in a similar fashion, with the employer's obligation to contribute fixed under a collective agreement. We recommend that the Panel consider an expansion of the PBA so that this type of plan could operate in an environment where there is no bargaining agent.

3. Jointly sponsored pension plan (JSPP)

Our third alternative to the current regime is the jointly sponsored pension plan (JSPP). The most commonly known example of a JSPP is a MEPP. However, most private sector employers at our Roundtable indicated that MEPPs have little appeal to them, since pension plan terms are one of the ways they define their corporate culture and differentiate themselves from their competitors in the marketplace. We strongly support the use of single-employer JSPPs, such as those recently enabled by Ontario legislation. Quebec's JSPP variant should also be explored, although the value of this plan design would be greater if it could be implemented retroactively. Currently, the legislation requires that a new plan be set up, and that it cannot cover past service.

Another plan design option the Panel can consider is the Multi-unit Pension Plan (MUPP). A MUPP, which is currently available in Alberta, is a non-collectively bargained plan that is administered by two or more employers.

Please note that the presence or absence of a union and/or the use of different business models would lead to different choices around risk-bearing in pension plans. Some employers will be prepared to meet the capital requirements of fully-guaranteed pensions, with or without asset/liability mismatch risks and margins, while others will not. Some will willingly share governance, surpluses and deficits, but others will not. Within a single employer, there are often different groups of employees with different degrees of attachment to the employer and different levels of financial acumen. Employers want the freedom to choose the designs that best suit their circumstances.

Fundamentally, action by governments is needed to address the present asymmetry in the pension system. In the absence of such changes, private-sector plan sponsors may increasingly decide to fully wind up their pension plans, or convert them to DC. However, many employers do not want this to happen. They recognize the value of DB pension plans, and believe they are superior to money purchase retirement savings arrangements, in terms of their efficient delivery of retirement income security and their value as human resource management tools.

DB versus DC Plans

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?

We believe strongly in preserving the DB pension system in Nova Scotia and improving it to serve the needs of today's and tomorrow's workforce. DB pension plans provide income security for employees, an attraction-retention tool for employers, and an important complement to the government's retirement income system.

DB pension plans can be a valuable workforce management tool for an employer and valuable to plan members[1]. A recent Watson Wyatt survey found that employees may be more dedicated to employers with DB pensions and that such plans have the power to attract and retain workers, particularly older workers[2]. Employees who perceive their pension plan as having value can be more committed to their employers, which can be linked to greater organizational success[3].

Hopefully, both the federal and provincial governments will take action to reverse the trend of DB to DC conversions and promote the introduction of more new DB plans. If not, the decline in DB plan coverage may well have profound social implications in the years to come. The adequacy of income replacement ratios that can be derived from DC plans depends on both the sufficiency of plan contributions and the adequacy of investment returns. However, studies of investment behaviour of DC plan members consistently indicate that members do not maximize their contributions and invest conservatively[4]. Such behaviour is likely to produce inadequate retirement income, making it difficult for DC plan members to maintain their standard of living after retirement, and leading to increasing reliance on government benefits. DC plans are also often undermined by fees for high investment management, record keeping and financial planning that are much higher than the expense ratios for larger DB plans.

As discussed under "Types of Plans" above, we believe that amending the Nova Scotia pension legislation to facilitate the development and maintenance of a number of different risk-sharing plan designs is essential to maintaining and expanding DB pension coverage.

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

We believe that the guidance on the extent and type of DC investment options provided in the Joint Forum of Financial Market Regulators' *Guidelines for Capital Accumulation Plans* (CAP Guidelines) is sufficient. Further, we do not believe that the vast majority of DC plan members are concerned about not having enough investment choice. In the 2008 Survey on Pension Risk, conducted by Watson Wyatt Worldwide and the Conference Board of Canada, 45 percent of respondents (CFOs and VPs HR) indicated that the lack of plan members' interest in their pension arrangements was a very serious threat to the sustainability of DC plans[5].

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

We believe strongly that new forms of DB plans should be permitted to enhance their availability. Details regarding plan types for consideration are provided in "Types of Plans", above.

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?

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1 S. Nyce, *Behavioral Effects of Employer-Sponsored Retirement Plans*, Journal of Pension Economics and Finance (2007), 6: 251-285.

2 Ibid at 15.

3 Ibid at 37.

4 See, for example, Richard A. Davies, *Keeping 401(k) Costs Reasonable: The Return of the Collective Investment Trust:* Alliance Bernstein, February 2007.

5 For more information on the 2008 Survey on Pension Risk, please see: *Concerns Diminishing About Pension Risk as a Long-Term Crisis*.

We believe that members of DC plans should, at the plan's option, be able to receive benefits directly from the plan fund. This has been possible in Alberta since August 2006 through the creation of the DC Retirement Income Account (DC RIA). Benefits payable through the DC RIA are calculated according to the rules applicable to Life Income Funds (LIFs)[6]. Similar options exist in Manitoba and in Saskatchewan, where DC plans can permit the payment of a variable benefit pension (VB Pension) directly from the pension plan[7].

Pension Plan Funding

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

We believe that the current going concern and solvency funding valuation requirements are appropriate and should be maintained. Solvency and going concern valuations provide important and distinct information on the adequacy and sustainability of contributions. We recognize that regulators should be most concerned with valuations on wind-up, as the loss of benefits after the insolvency of a plan sponsor is the most problematic for plan members, regulators and governments. However, the solvency funding valuations are flawed as a basis for long-term funding of pension plans. The cash required to settle pension benefits through the purchase of annuities or the payment of lump sum commuted values often far exceeds the size of the pension fund that needs to be invested to generate the same level of pension benefits. This is in part due to the extra return expected on the investments included in most pension funds and in part due to early retirement subsidies and other optional features that must be included in settlement values on the presumption that plan members will act to maximize the value of these features. Going concern valuations address these concerns by taking account of the pension fund investment policy, the pattern of turnover and early retirement, and other contingencies in a continuing pension plan. They include an element of conservatism, so that future actuarial gains will be more likely than actuarial losses, but the degree of conservatism and choice of assumptions is best left unregulated, determined by the actuary and the plan sponsor in conjunction with the plan's funding policy and actuarial standards of practice.

We recommend the preservation of both solvency and going concern valuations, provided that the issues associated with solvency valuations can be resolved. For example, asset smoothing should not be permitted in solvency funding, as smoothing may give a false impression of the degree of benefit security, in effect providing a second component of amortization that is not specifically disclosed. An extended solvency amortization period is a better and more transparent alternative. Use of letters of credit (LOCs) in lieu of cash payments similar to what Alberta has adopted is also recommended as an escape valve for sponsors who seek to avoid overfunding. We note that the Alberta approach is more far-reaching than the temporary LOC measures adopted by the federal government and more attractive to employers than the Quebec approach to LOCs.

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

If strengthened solvency rules are established as discussed above, we caution that they may not be appropriate for certain sectors or types of plans. MEPPs and other risk-sharing arrangements may experience undue hardship through the use of these valuations. To address this concern, plans

6 Further information on DC RIA's can be obtained from Alberta Finance Policy Bulletin #30, *Defined Contribution Retirement Income Accounts*.

7 Further information on VB Pensions can be obtained from Manitoba Update 34, Variable Benefits Under a Defined Contribution Plan and from Saskatchewan Highlights of the PBA Regulations 2006.

could be permitted to apply to the regulator to have solvency funding requirements waived temporarily if they can demonstrate that the current benefit level is sustainable under appropriately conservative going concern assumptions.

In addition, we believe that the issues facing municipalities and universities are such that they make a case for being exempted from standard solvency funding rules. This is consistent with the approach adopted in New Brunswick and Quebec. Alternatively, the approach taken in the Federal solvency relief regulations might be appropriate. Crown corporations were given the choice of purchasing a guarantee from the Federal Government, rather than purchasing a Letter of Credit from a private sector bank.

Should going concern funding still be a requirement?

As discussed above, we believe that going concern funding should still be a requirement.

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

We believe that amending pension legislation to encourage the development of a range of risk-sharing plan design options, as discussed above, will allow plan sponsors and members to choose the arrangement that provides the level of short- and long-term benefit security best suited to their particular situation.

The current funding rules do not merely require prudence in the long-term funding regimes adopted by employers. They impose solvency minimums that ostensibly protect plan members from the loss of benefits in the event the plan sponsor becomes insolvent. Unfortunately, asking employers to keep enough money in a pension plan to completely eliminate the risk of loss of benefits on insolvency would make pension plans unaffordable or would result in significant benefit reductions.

In Ontario, the political compromise has been to exclude a number of important classes of uninsurable benefits from the solvency funding target. As a consequence, solvency funding is inadequate to ensure all of the benefits can be paid upon plan wind-up and yet at the same time exceeds the long-term cost of benefits. The political compromise by the Federal Government has been to increase amortization periods and to allow LOCs in lieu of solvency payments in certain circumstances.

This has given rise to a situation in which representatives of pension plan members can argue that members bear too much risk, while plan sponsors see contribution levels and fluctuations in contributions that are prone to producing unintended benefits to plan members. To address this imbalance, we agree that promises regarding future benefit accrual should not be unlimited, but should instead be restricted to the level that can be funded by contributions. Depending on the risk-sharing arrangement, member and/or sponsor contributions can be increased to ensure funding for promised benefits.

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

We do not believe that a retroactive change in the basis upon which current pension plans were established can be justified. Requiring employers to guarantee the benefit, even after the plan is wound up, rather than requiring employers to fund the benefit while the plan continues, would represent an important philosophical change in the nature of the DB promise. This requirement might be reasonable in the "Fully Guaranteed" model of pension plans we discuss at pages 4-5 but would not be reasonable in a jointly sponsored or member-funded pension plan.

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 MEPP?

We would require additional details about the contemplated plan design in order to respond to this question.

Surpluses

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

As stated under "Types of Plans" above, we believe it is essential to definitively resolve the issue of who ultimately owns pension funds, together with the related risks and rewards. Nova Scotia's PBA and Regulations should be amended to facilitate the implementation of plan designs that permit an allocation of risks as determined by the plan sponsor(s) and members. The issue of surplus ownership can then be definitively resolved by stating that the right to any surplus that may arise rests with the party, or parties, who bear the risks.

While the system outlined above should resolve surplus disputes on a going-forward basis, we realize that it can be difficult to determine surplus/risk ownership in older pension plans. Determining the true nature of the "pension deal" for an older plan requires a thorough review of all plan and trust documentation, which is time-consuming and expensive. While the old plan can be closed in favour of a successor plan with clearer surplus language, this is also costly, and does not eliminate the problem posed by the old plan wording. To address this situation, Nova Scotia should consider amending the PBA and Regulations to enable plan sponsors to clarify surplus entitlement by amendment, as is currently possible in Quebec. This would provide clarity while avoiding the costs of a lengthy document review or the implementation of a successor plan.

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 to surplus?

The validity of the "deferred wages" concept depends on the nature of each pension deal, and is neither universally applicable nor irrelevant. While there may be cases, particularly in a collectively bargained environment, where plan members expressly choose pension enhancements over wage increases, this is not always the case. Whether plan members are entitled to plan surplus under the deferred wages argument depends on the facts of a given case.

Rather than focusing on this concept, we believe the more prudent approach is to tie ownership of surplus with responsibility for plan funding risks. This better reflects the true nature of particular pension arrangements, and accommodates a range of risk-sharing plan designs.

Multi-Employer Pension Plans

How should funding concerns for MEPPs be addressed? Would permitting the implementation of a different type of hybrid pension plan be useful for MEPPs?

We prefer to leave issues regarding MEPP funding tests to others, as we do not act as consultants to MEPPs other than in the public sector.

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

Contrary to the assertion in the Discussion Paper, the Quebec model is not really a hybrid plan. Rather, it is a DB plan that allows for the reduction of benefits in specified circumstances. While it may still be a valuable plan design idea for Nova Scotia, the Quebec model is not a true hybrid plan design.

As noted in our section above entitled "Types of Plans", we believe that it is beneficial for legislation and regulation in Nova Scotia, and elsewhere in Canada, to facilitate and encourage the development of a range of plan designs. These comments apply equally to the development of hybrid plans.

Governance

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 believe that governance structures should reflect the pension risk-sharing arrangement. Many employers believe that a shared governance process should only be available where members also share funding risks.

We believe that responsibility for plan governance should align with responsibility for plan funding. For example, where both the employer and plan members are responsible for plan funding, the pension plan should be governed by a pension committee or other joint body. While it is the approach taken by Quebec and Manitoba (subject to limited exceptions), we do not believe pension committees are necessarily the appropriate governing body for all pension plans nor are prescribed governance rules appropriate for all plans.

Quebec's experience with such bodies has been mixed. We believe that where the plan funding still resides with the employer, as is the case for most plans, some of the powers currently held by pension committees are inconsistent with the true risk-sharing arrangement. The fact that they administer plan funds and investments is inconsistent with the funding risk that resides with the employers. As such, a joint committee is not the appropriate "administrative" body to be handling funding matters in the absence of a true risk-sharing arrangement.

To address your specific question, making the governance process overly prescriptive along the lines of the "Sarbanes Oxley" changes in the United States would be counter-productive. The appropriate governance structure should reflect the true nature of the plan, its characteristics and its level of risk management. Governance is better presented as principles which serve to ensure that the plan is administered appropriately with the right people doing the right things, and ensuring that there is some measure of responsibility, accountability and transparency. In reality, even in Quebec, where pension committees have existed since 1990, most pension committees serve an oversight function rather than a true administrative function, ensuring that responsibility, accountability and transparency are looked after.

Finally, we believe that plan members should receive relevant information regarding the financial position of their pension plan. We note that the relative importance of the information depends upon the extent of the plan sponsor's obligation to fund the plan's past and future benefits. Additional disclosure to plan members regarding funding decisions and contribution holidays can best be accomplished through requiring that pension plans establish a written funding policy and provide that policy to members, retirees and other beneficiaries. A funding policy would cover additional important issues such as the relationship of investment policy to liability structure.

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

We believe that governance structures should reflect the pension risk-sharing arrangement. The related cost of the governance process will also vary depending on the particulars of the pension arrangement and the risk management involved. The required governance budget will depend in part on the complexity of the investment strategies undertaken, which in turn depends on the risk/reward objectives of the plan. No two plans are the same so the costs or even the governance cost items will differ from plan to plan based on plan design, administrative complexity, funding and even membership characteristics. Accordingly, we do not believe it is possible or advisable to establish a set cost for "good governance". In fact, better governance process may in fact reduce plan costs through the access to investment solutions which may be inappropriate for plans with limited governance budgets or by reducing the risk of errors of lawsuits.

Role of Regulators

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?

We have not experienced any difficulties with Nova Scotia's current regulatory system, or with its appeals process. Accordingly, we have no changes to recommend.

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?

We do not believe that plans with below a specified number of employees should be exempt from all regulation, as this could jeopardize the benefit security of members. However, we believe that the administrative burden on small plans should be reduced where possible. Accordingly, we recommend that while certain minimum standards, such as those relating to funding and benefits, should apply to all plans regardless of the number of members, other administrative standards should only apply once a specified membership threshold is crossed. Such is the case in Quebec, which exempts plans with less than 25 members from the requirement that the plan administrator be a pension committee.

We believe that 25 members is an appropriate threshold, but that a detailed examination of the minimum standards in the PBA and Regulations be conducted to determine which rules are appropriate for exemption.

Unlocking Funds

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

Given the goals set out originally for pension plans as regards protection of benefits and consistent with our belief that pension plans are there to provide retirement income, we feel that increasing the level of unlocked funds in pension plans goes against these principles. We agree that unlocking small amounts can reduce administrative costs for individuals, and that unlocking in circumstances of financial hardship circumstances may be appropriate. However, completely eliminating locking-in requirements undermines the government's (and employers') objectives in supporting the private pension system.

Grow-in Benefits

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

Consistent with our recommendation to the Ontario Expert Commission on Pensions, we recommend that Nova Scotia eliminate partial wind-ups, and related grow-in rights. This approach was adopted by Quebec, in exchange for immediate vesting and an additional termination benefit based on notional indexation during part of the deferral period for all plan members. Quebec also specified a 3-year window prior to a full wind-up for the purpose of identifying the former plan members who must be included in a process for the distribution of surplus. The introduction of immediate vesting removed the distinction between plan members who terminated as part of a group and plan members who terminated individually. While there may be a political difference between one termination and a thousand, for any particular employee, there is none.

Nova Scotia could follow a similar approach, eliminating partial wind-ups, and related grow-in rights, in exchange for immediate vesting or the introduction of additional termination benefits similar to Quebec.

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

As we recommend the elimination of grow-in rights, in exchange for immediate vesting, there is no need to fund grow-in benefits. Once again, while identification of solvency liabilities is important, funding these benefits is problematic.

"Safe Harbour" Rules

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

We support the provisions of a safe harbour for administrators of DC pension plans in specified circumstances, and believe appropriate provisions should be codified through legislative and regulatory amendments in Nova Scotia. These guidelines should be based on the CAP Guidelines. They reflect industry guidelines and best practices on the subject of investment options.

The development of safe harbour provisions should also be based on the current safe harbour provisions found in section 404(c) of the United States *Employee Retirement Income Security Act* (ERISA). The basic safe harbour rule provides plan fiduciaries with relief from liability for investment losses where participants are entitled to (and do) select their own investment options that meet the prescribed criteria.

Regardless of the model, we believe that the safe harbour should relieve DC sponsors of liability for poor investment performance if they can establish that they allow plan members to:

- Choose from a range of diversified investment alternatives with different risk and return characteristics;

- Give investment instructions either quarterly or at a frequency that corresponds to the volatility of the investment options selected; and
- Obtain information that allows them to make informed decisions on the investment options offered.

Phased Retirement

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

The only provinces with legislation facilitating phased retirement are Alberta, Quebec and Manitoba, although Manitoba's legislation still requires proclamation. Nova Scotia's PBA and Regulations currently contain no provisions governing phased retirement. Accordingly, such provisions will need to be added to the legislation and regulations in order for it to be implemented in the province. These additions should reflect recent changes to the federal *Income Tax Act* (ITA) and related Regulations, which allow plans to offer the accrual and payout of pension at the same time.

We believe that Nova Scotia should amend the PBA and Regulations to allow employers to offer phased retirement to their workers. While phased retirement programs should not be mandatory, their existence as an option can provide much-needed flexibility to employers facing labour shortages.

Tax-Free Savings Accounts (TFSAs)

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

TFSAs can provide a valuable new way for employees to save for a number of purposes, including retirement. Like Group RRSPs, TFSAs are capital accumulation plans (CAP), and are therefore covered by the standards set out in CAP Guidelines. Nova Scotia's regulatory position on TFSA's should accordingly be to ensure that they are administered according to these established principles, and not subject to the PBA.