21 November 2008

Submission to the Nova Scotia Pension Review Panel

Response to Interim Position Paper

MERCER

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Consulting. Outsourcing. Investments.

For more information, contact:

Paul Forestell, Worldwide Partner
416 868 2952
paul.forestell@mercer.com

Doug Brake, Principal
902 490 2117
doug.brake@mercer.com

Lori Park, Principal
902 490 2145
lori.park@mercer.com

We appreciate the solicitation of comments on the Pension Review Panel's Interim Position Paper ("Paper") and the very open manner in which the Panel has conducted its affairs. It is obvious that the Panel recognizes the importance of an efficient and effective pension regulatory system for Nova Scotia, and we are pleased to provide our comments on the Paper with the intention of assisting the Panel in meeting its objectives.

Support for Panel's Positions

We are pleased to say that we are in agreement with a significant amount of the Paper's content. On a general level, we fully support the concept of flexible regulation, allowing design innovation while protecting member benefits. Of the specific contents of the paper, we support the following critical components:

- Immediate vesting;
- Appeals from Superintendent decisions to an independent adjudicative board. Please note that we believe it is critical that the board include individuals with pension expertise;
- Phase-out of legislated grow-in (with inclusion in valuations, if retained in plan terms);
- Elimination of partial wind-ups;
- Exemption from regulation of plans solely for connected persons;
- More flexibility and elimination of the prescribed list of employee classes; and
- Legislation should permit phased retirement, but not require it. We also recommend that legislation on phased retirement should give employers the flexibility to offer phased retirement on a discretionary basis to selected individuals (not necessarily to the entire plan membership).

Areas of Concern

There are several areas of the Paper where we respectfully suggest revisions be made. We believe such revisions could lead to a robust regulatory scheme that balances employer and employee interests more fairly, and that secures benefit promises while allowing additional flexibility in plan design and management. The basic areas of concern are explained below.

Minimum Funding Requirements

Perhaps one of the most significant departures the Paper makes from the *status quo* and from other pension jurisdictions, including the direction other jurisdictions are heading in, is with respect to minimum funding standards. This further exacerbates an already non-uniform pension environment across the country.

The proposed funding standards cause us concern for several reasons, most of which are related to the member transfer value basis:

- The actuarial basis for determining member transfer values would diverge from the Canadian Institute of Actuaries' standard, which is universally applied as the transfer value basis by all jurisdictions in Canada; and

- As proposed, the transfer value basis would include a value for subsidized early retirement benefits to which a member might not be entitled upon termination of employment (a form of "grow-in" for all members).

Fundamentally, the concern of regulators must be to secure the pension promise. This means funding to a wind-up standard.

We favour a pure, or nearly pure, wind-up liability, including all benefits promised by the plan. This will be significantly higher than the current standard, especially for plans that exclude escalated adjustments from their solvency liability. Consequently, we favour a long transition period to the new standard and a longer period over which to amortize deficits. We had suggested 10-year amortization with interest in our earlier submission, which is similar to the Paper's 8-year straight line amortization.

Funding Relief

While it was not contemplated in your mandate when it was originally struck, the sharp decline in equity markets this year has regulators and legislators across the country considering pension funding relief measures. We believe that funding relief is needed and we strongly support the following two measures (on a temporary basis) in this regard:

- Allow the smoothing of investment losses over a 5-year period to allow sponsors to recognize these losses in an orderly fashion; and

- Allow sponsors to amortize deficits over a 15-year period.

As and when markets improve, this temporary relief can be lifted and the usual funding provisions reinstated.

Exemptions for Certain Plans

Where solvency is not an issue because wind-up is highly unlikely, funding to a wind-up standard is not appropriate, especially where there are mandated benefits payable only upon wind-up, such as grow-in benefits, that will in all likelihood never be paid. Further, funding to an annuity purchase target for retirees is very expensive if, at the end of the day, annuities will never be purchased and assets will be invested in a portfolio that is expected to deliver better long term returns than those underlying annuity purchase.

Consequently, we believe that the regulations should differentiate between those plan sponsors exposed to wind-up risk and those for whom wind up is realistically not an issue, which potentially includes plans in the municipal, health care and university sectors.

Limitations on Benefit Improvements

The Paper indicates that a plan will not be permitted to improve benefits while it has a deficit. This is an unnecessary provision that interferes with plan management and restricts the flexibility that plan sponsors and employees currently enjoy.

Provided the minimum funding contributions are made to fund benefits earned on an on-going basis as well as funding deficits over the prescribed time periods, a plan should be permitted to make benefit improvements. On wind-up, regulators should be granted discretion to allow the 'roll-back' of recent amendments where there are insufficient assets to pay the associated benefits.

Fixed 3-Year Valuation Dates

The Paper indicates that plans will be required to file valuations at fixed 3-year intervals. We would suggest that this is unnecessarily rigid.

Plan sponsors typically manage their plans quite carefully and are usually aware of the financial position of their plans, in broad terms, on an on-going basis. Under the current regime, plan sponsors file valuations at intervals of no more than 3 years, but sometimes earlier to manage their cash contributions (up or down) and sometimes at off-cycle dates if there is a significant plan event such as a merger or divestiture or a significant plan amendment.

Surplus

The Paper states that cash may be withdrawn only after wind-up when all obligations have been met, subject to the employer having paid at least 50% of net contributions over the previous 10 years. The Paper goes on to state that the employer may not receive more than 50% of surplus.

This raises the issue of asymmetry, which has dogged defined benefit pension plans for years, and which is a significant contributing factor to the decline of defined benefit pension coverage in this country. Where an employer can otherwise establish its legal ownership of surplus, legislation limiting employer access in this fashion divests legal rights, and interferes in the freedom to contract. A blanket rule limiting employer access does not fairly balance risk and return in the significant number of plans where the employer is solely responsible for funding deficits and in non-contributory pension plans.

We continue to believe that asymmetry is a serious problem for defined benefit plans, and that legislation should respect the agreements made by parties to the pension deal, not impose new terms that favour one side over another, and that are not necessary to the fundamental purpose of the legislation -- securing member benefits.

We do not agree that pensions should be characterized as deferred wages. That philosophy is clearly aligned with labour's approach to pension issues, and does not adequately consider the interests and rights of plan sponsors. We believe the appropriate legislative treatment of these contentious issues is a balanced perspective that respects the terms of the deals actually made and does not inherently favour one side over the other. And even if the Panel does choose to adopt a deferred wages approach to pensions, we suggest that it is the pension payments which are the deferred wages, not the funding set aside to secure those pension promises and which will often be more or less than is necessary to provide such pensions at any given point in time.

Governance

The Paper calls for the filing of a "Governance Plan" with the Superintendent of Pensions, who would review the plan for conformity with generally accepted practice in the pension industry. We are concerned with this suggestion for a few reasons. Most importantly, appropriate governance of a pension plan is both contextual and evolving. There is no universal standard that works for all plans. We believe that a filing and review requirement will stifle flexibility and innovation, and unduly burden regulatory resources, without providing improved outcomes for plan members.

Pension plans are already subject to comprehensive governance guidelines, fundamental governance controls in the legislation, and an array of common law responsibilities. We believe this backdrop is sufficient. Additional governance regulation will deflect limited plan resources away from more meaningful activities, and we believe it is not likely to result in better outcomes for plan members.

DC Plans – who should limit investment choices?

We agree that the plan sponsor (or administrator, as the case may be) should select the investment options available to DC plan members, and applaud the inclusion of rules that would allow automatic enrolment and default investment options for those who do not make active elections. However, we do not support a requirement to file the array of investment options and rationale for their adoption with the Superintendent of Pensions, who could then presumably review and reject those options. Like our concern with the filing of governance plans, we believe this requirement could quickly stifle flexibility and innovation, and consume both plan and regulatory resources without a benefit for plan members. The selection and monitoring of investment options is a highly complicated task. It requires significant resources and technical skill. We believe this additional, very significant, layer of new regulation is unnecessary, given the legislative, common law and regulatory guideline controls already in place. We also believe it runs counter to goals of enhancing flexibility and reducing unnecessary regulation.

On a related note, we believe that a requirement to provide pension projections to DC members will increase the legal risk to which employers are exposed and do not support such a requirement. However, if DC plans are required to provide pension projections, there should be prescribed guidance for those projections, as the virtually endless array of scenarios available for any given plan member would be overwhelming.

Employers/administrators should be granted safe harbour protections (*e.g,* from negligent misrepresentation claims) in providing projections on prescribed terms.

Access to Plan Professionals

We have a very serious concern with the suggestion that Advisory Committees / employees must have access to plan actuaries and other professionals to communicate with them independent of the sponsor, with the plan to pay associated costs. This would effectively impose professional relationships on plan advisors, and the associated liability that would otherwise not be voluntarily assumed. We have a critical concern about conflict of interest and breach of privilege/confidentiality arising from this suggestion. We consider the risk for conflicts of interest, in particular, to be virtually certain to materialize and insurmountable on the basis of the professional standards that apply to many pension professionals. We also note that this could result in very significant cost increases for plans.

Types of Pension Plans

We agree that flexibility in plan design is a positive goal, and that the adjustable contribution/benefit plans discussed in the Paper could be useful in some environments.

However, we do not agree that joint trusteeship should be mandatory for the administration of these plans. Joint trusteeship is appropriate in some circumstances, but not all. For example, an employer in a non-unionized environment is unlikely to establish a pension plan it cannot control. A plan sponsor who is otherwise willing to comply with legislative requirements and standards for member protection should not be discouraged from establishing a plan on the basis of a mandated joint trustee structure. Again, pension plans are voluntary arrangements and serve the general employment relationship. Structures that do not reflect employment realities will simply mean plans will not be adopted.

We note that the Paper does not address the institution of jointly-sponsored plan rules, similar to those adopted in Ontario. Given that there are large and important plans under the jurisdiction of the Nova Scotia *Pension Benefits Act* that could benefit from the adoption of such rules to facilitate their operation, we believe these structures should not be overlooked.

DC Members - Access to Different Disbursement Methods / Unlocking

We agree in principle that greater flexibility for members is a positive thing, and we do not disagree with a requirement that would allow defined contribution plan members to fully or partially annuitize at age 60 (or as early as age 55 for that matter). However, we are concerned that any other unlocking during active employment should only be available if adopted by a particular plan. We are unsure whether the Panel would recommend the unlocking options described in the Paper be made available to anyone at age 60, regardless of whether still employed or not. We strongly believe that the plan sponsor should be permitted to limit unlocking by plan terms for active employees, both in defined contribution and defined benefit arrangements.

Trend Toward Fewer DB Plans / Promotion of Pension Plans

We agree that government should encourage increased pension plan coverage through more flexible regulation, but are not convinced that promotional activity will lead to an increase in plans. In our experience, it is not lack of awareness of the value of pension plans that impedes their growth, it is the inflexible and onerous regulation and financial risk/volatility. If plan promotion is undertaken by government, it should not be charged to current plan sponsors, even indirectly through the various regulatory fees imposed on plans.

Province-wide Pension Plan

We believe that a province-wide pension plan for those without current coverage is a good idea in theory, but caution that this would be a very significant undertaking in terms of the resources required to establish and maintain such a plan. We urge a cautious approach that will ensure the commitment of resources is not disproportionate to the benefit.

Jurisdiction Issue

We understand the Panel is suggesting that Nova Scotia would cede jurisdiction to the province of registration for NS members of multi-jurisdictional plans. We note that this is inconsistent with current practice nationally and is inconsistent with the proposed Agreement Respecting Multi-Jurisdictional Pension Plans recently put forward by the Canadian Association of Pension Supervisory Authorities. To ensure equity between Nova Scotia plan members, we would prefer to see an approach that was consistent with the other pension jurisdictions on this issue, and that would see all Nova Scotia members subject to the same minimum standards on member benefit issues.

Harmonization

With respect, we believe the concept of harmonization of pension standards is more important that the Panel's proposals would suggest. We agree that flexibility can be positive, but seriously divergent standards mean we will not benefit from the developments in other jurisdictions (jurisprudence, policy formulation, system developments) and that our influence in pension policy matters is unlikely to be significant. We believe that commonality on fundamental issues (such as use of CIA transfer values) is an important part of ensuring a measure of equity for Nova Scotia plan members.

MERCER

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Mercer (Canada) Limited
1801 Hollis Street, Suite 1300
Halifax, Nova Scotia B3J 3N4
902 429 7050

Consulting. Outsourcing. Investments.