



HUMAN RESOURCE CONSULTING AND ADMINISTRATIVE SOLUTIONS

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By email: pensions@fin.gc.ca

Ms. Diane Lafleur  
Financial Sector Policy Branch  
Department of Finance  
L'Esplanade Laurier  
20<sup>th</sup> Floor, East Tower  
140 O'Connor Street  
Ottawa, Canada K1A 0G5

Dear Ms. Lafleur

**RE: Morneau Sobeco Submission on Consultation Paper**

On behalf of Morneau Sobeco, I am pleased to submit comments regarding the consultation paper, *Strengthening the Legislative and Regulatory Framework for Private Pension Plans Subject to the Pension Benefits Standard Act, 1985*. This initiative is important to us and to our clients. Morneau Sobeco is the largest Canadian-owned actuarial and human resources consulting firm and has many clients who sponsor federally regulated pension plans. We have over 2,200 employees, including more than 120 actuaries and Associates of the Society of Actuaries and ten pension lawyers working out of 11 offices across Canada.

We commend this initiative by the Department of Finance (“Department”) to seek ways to strengthen the legislative and regulatory framework for private pension plans. It is timely, coming on the heels of major pension reform papers produced by the Nova Scotia Review Panel, the Ontario Expert Commission on Pensions (OECF), and the Joint Expert Panel on Pension Standards (JEPPS) in Alberta and BC. Given that these other papers contain valuable recommendations, we will make reference to them below in our comments on the questions posed by the Department in its Consultation Paper.

**Solvency measurement and funding rules**

We strongly support the continued use of solvency valuations to measure the funded position of registered pension plans. The most important funding goal is to provide benefit security and the best measure of benefit security is the funded status of the benefits that have accrued to date.

At the same time, funding based on solvency valuations alone will not guarantee benefit security, nor are solvency valuations the only tool that can or should be used to determine the pace of funding. Going-concern valuations should also continue to be required since there will be times when funding will be

“going-concern driven” rather than solvency driven. The funding target under solvency valuations should include a provision for adverse deviation of 5% to match the recommendations made by some of the expert panels.

Even with these measures, funding deficits will still arise from time to time as is the case right now. We have to recognize this as an ongoing risk within the system of occupational pension plans that can only be partly addressed by stricter funding rules.

We agree that a mark-to-market approach to funding based on solvency valuations can result in “trapped capital”, especially in the current environment of depressed asset values and historically low solvency discount rates. This can be a significant deterrent to establishing or continuing a defined benefit (DB) pension plan. In a voluntary pension system, it is desirable to remove deterrents to maintaining DB plans to the extent possible without compromising benefit security. To this end, we strongly urge the Department to consider all of the following additional measures:

- > allow the use of letters of credit to replace all or a portion of the solvency amortization payments that would otherwise be needed,
- > allow plan sponsors to establish a Pension Security Fund (PSF) as was recommended by JEPPS. A PSF would allow employers to fund the excess of the solvency liability over the going-concern liability without raising the concern that this would become trapped capital; in many ways, a PSF is superior to the use of letters of credit though both measures should be available to plan sponsors,
- > expand the "deemed trust" principle embedded in the PBSA 1985 to provide members a security safety net in the event of insolvency of the plan sponsor. For instance, upon insolvency, pension deficiencies related to pensions in payment and other pension liabilities (both up to reasonable thresholds) could be subject to such deemed trust.

### **Full funding on voluntary plan termination**

It is suggested that plan sponsors should be required to fully fund a pension plan on voluntary plan termination. We agree this is a reasonable requirement provided that there is a suitable transition period before it is fully implemented.

### **Eliminating Partial Wind-ups**

We agree that partial wind-ups should be eliminated and acknowledge that this essentially requires immediate vesting regardless of length of service. There seems to be a trend to immediate vesting in any event. It is already law in Quebec and has been recommended by the OECP and the NS Review Panel.

The one downside to immediate vesting is the substantial administrative burden it would entail if it is not implemented judiciously. Currently, processing termination benefits requires the preparation of termination options forms, explanation of options to the member and obtaining the requisite sign-offs to transfer the monies to a third party. This is a cumbersome process and is not justified for small amounts. We would therefore recommend that immediate vesting be accompanied by the unilateral right of the plan sponsor to pay out small amounts in cash on termination (or any amount on termination with less than

two years of service) without the employee's written consent to this form of settlement. The definition of small amounts could be tied to a percentage of the YMPE under the Canada Pension Plan, such as 20%.

### **Information to members and funding policy**

The idea of a formal Statement of Funding Policy has been endorsed in many quarters and we are not averse to it. We would suggest, however, that such a policy might be of limited usefulness in light of the ongoing issue of surplus asymmetry. As long as employers feel they are on the hook to pay funding deficiencies but cannot utilize surpluses, many will feel their only sensible course of action (short of a plan wind-up) is to make the minimum possible contributions to their DB plans. Hence, mandatory Statements of Funding Policy will tend to be worded as broadly and vaguely as possible and adopted solely for the sake of compliance, not for practical guidance.

A Statement of Funding Policy becomes more useful if letters of credit and a PSF are permitted; it is reasonable that the employer should be expected to set out their policy on the use of such instruments.

We strongly endorse the idea of communicating plan information electronically. It is more efficient, less expensive and friendlier to the environment. In the case of active members, especially, communication via email or intranet should be the norm or default unless the member specifically requests a paper version.

### **Contribution holidays**

We believe the right to take contribution holidays should be enshrined in legislation. Otherwise, it will remain an ongoing point of contention. In plans where active members are formally required to contribute more in the event of a funding deficit, it would be appropriate that the employees share in any contribution holidays on a pro-rata basis. These provisions could be set out in a Statement of Funding Policy but that would be practically superfluous if they are clearly stated in the pension legislation.

While we understand the reason for allowing contribution holidays only in years in which a valuation report is filed (and which shows a solvency surplus), we would suggest a slightly more flexible solution. We believe a contribution holiday should be allowed in non-valuation years too, provided that the actuary submits a certificate to the effect that in his/her opinion, the plan is in surplus at the beginning of such year. It may be appropriate for the Superintendent to reserve the right to suspend such contribution holiday during the year (or to request that the actuary re-confirm the surplus position) if there is reason to think that there may have been a significant deterioration in the funded position since the actuary's initial certification was filed.

### **Void amendments**

We are in agreement with a solvency threshold below which a benefit improvement would be a void amendment. That threshold could be a solvency ratio .85 or .80 but we concede that there is no one correct answer. The assets in a PSF (if such a vehicle is permitted, as recommended above) would be included for purposes of determining the solvency ratio. The one modification we would suggest is that

an amendment be permitted if the plan sponsor makes a one-time contribution that would bring the solvency ratio up to the established threshold.

### **DC Plans – Safe harbour**

We endorse the idea of establishing safe harbour protection for the sponsors of defined contribution plans. How well this works depends on how the safe harbour is defined. A good starting point would be the CAP guidelines but it would be critically important that the safe harbour rules continue to evolve as new DC products, concepts and plan innovations emerge. It is not clear what mechanism could be put in place to ensure that this happens but this merits further study.

Interestingly, the protection of a properly implemented safe harbour might lead to a migration from group RRSPs to DC pension plans and thus help address the low level of pension coverage in the private sector.

### **DC retirement benefits paid directly from the pension fund**

The idea of receiving retirement income directly from the pension fund should appeal to many employees in DC plans because it is administratively simpler for them and the management fees should be substantially lower than in a retail mutual fund.

Of course, not all plan sponsors will want retired DC members to take their retirement income from the pension fund rather than purchasing an annuity or transferring the lump sum to an RRSP or LIF. It would entail an extra legal and moral obligation that the employer does not have now. One danger is if the account balance is drawn down to virtually nil at some point and this imposes a moral obligation on the part of the employer to supplement retirement income.

To the extent that an employer is willing to offer this option, we see no reason not to allow this under the PBSA. It would, however, be important that regulations be prescribed governing the amount of retirement income that can be drawn by the member on an annual basis and the expenses that can be charged against the member's account.

### **Use of surplus in DC plan components**

Many sponsors of DB plans have added a DC component to cover future service benefits. To the extent such plans were in surplus, it has been common practice to use the surplus that had accumulated under the DB provision to take contribution holidays under the DC provision. We see no reason why this practice should change.

In many cases, the DB pension assets were held in a trust fund with a corporate trust company while the new DC provision was administered by an insurance company. This created a physical separation of assets in the same plan with the DB assets in the trust fund and the DC assets held by a different institution under an insurance contract. When DC contribution holidays are taken under such an arrangement, it has left some with the impression that surplus is being physically withdrawn from the trust fund whereas in fact those assets remain in the plan, only they are now held by the insurance company.

We agree that it would be beneficial to clarify the practice of taking contribution holidays under the DC provision using surplus held under the DB provision. It should be made clear that this practice is acceptable regardless of the funding vehicle that is used to hold the DC assets.

### **Administrative Procedures**

While the suggestion is made in the context of DC plans, we believe that the plan sponsor should be able to transfer out the lump sum entitlements of deferred vested members of both DB and DC plans. The administration of deferred entitlements is an ongoing burden for plan sponsors and a frustrating one when members do not make any election at the time of termination and then cannot be located later on when the pension payment becomes due.

The OECF suggested creation of an Ontario Pension Agency to be a repository for such orphan pensions in its jurisdiction. The NS Review Panel and JEPPS both suggested a province-wide plan that would be available to all employers and employees. Such a government-sponsored plan could similarly act as a repository for orphan pensions. We suggest that the Department of Finance consider the creation of such a vehicle to hold the orphan pensions of former members of federally regulated plans.

There should be a further public consultation to consider the structure of this vehicle. Some sort of public-private response might be the best approach. Under one structure, the government would be responsible for the administration and universal accessibility of such a vehicle while private sector investment management firms would be given the opportunity to provide cost-effective investment vehicles with investment fees that are commensurate with the aggregate size of assets that are held. Under another structure, the government would also outsource the administration to one or more private sector service-providers. The keys to success in either case are accessibility and cost and government would likely have to play some role to ensure that they are achieved.

### **Flexibility of the PBA 1985**

We note that all three review panels strongly encouraged innovation in plan design. It is clear that traditional DB plans are no longer as attractive to many employers while DC plans have their own shortcomings. The pension community needs to be able to explore new plan designs that contain new combinations of DB and DC provisions.

We note that many hybrid plan designs which would afford more protection to individuals than existing DC plans are currently offside because of rules that never really contemplated certain types of hybrid plans. Cash balance plans (popular in the U.S.) are one example. If flexibility is to be encouraged in the future, a mechanism needs to be put into place to provide some guidance for plan sponsors as they consider design changes.

If the ultimate decision as to whether a particular design is acceptable is left to the discretion of OSFI, they will need some guidance. Rather than provide complicated rules about is and isn't acceptable, a principles-based approach may be more fruitful.

Ms. Diane Lafleur  
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One basic principle is that the member should be no worse off by participating in such a plan than if they made their own retirement arrangements. Interestingly, some defined benefit plans might fail that test at least for very short service participants so there has to be a reasonableness test. This leads to a second principle: a plan should be acceptable – regardless of its provisions – if it provides at least as much benefit at each age as a plan that is already acceptable. Hence, any DC plan with some DB guarantees layered onto it should be acceptable. A further consultation process may be useful to consider this question further.

We would be pleased to provide further detail on any of the above points.

Yours truly,

A handwritten signature in black ink, appearing to read "Fred Vettese". The signature is fluid and cursive, with a large initial "F" and "V".

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