TOWERS PERRIN

Submission of Towers Perrin in response to the

Department of Finance

Consultation Paper on Strengthening the Legislative and Regulatory Framework for Private Pension Plans Subject to the Pension Benefits Standards Act, 1985

March 2009

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March 13, 2009

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Dear Ms. Lafleur:

We are pleased to enclose Towers Perrin's submission on the Department of Finance's recent consultation paper on improving the framework for federally regulated private pension plans. We look forward to discussing any questions you may have on our submission.

Sincerely,

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1. Introduction

We thank you for the opportunity to make this submission to the Financial Sector Division of the Department of Finance (Department) on behalf of Towers Perrin regarding the Department's recent consultation paper entitled "*Strengthening the Legislative and Regulatory Framework for Private Pension Plans Subject to the Pension Benefits Standards Act, 1985"* (Consultation Paper).

We applaud the initiative of the Department in reviewing its pension legislative framework. We share the main objective expressed by the Minister of Finance, Jim Flaherty: "The purpose of this paper is to get the views of Canadians on issues related to the legislative framework for federally regulated defined benefit and defined contribution pension plans with the objective of making permanent changes in 2009."

Some 15 to 20 years ago, and earlier, the reforms introduced in pension legislation served to correct certain abuses, to increase the likelihood that pension promises made to employees were honoured, and to facilitate greater mobility of the workforce. We see this current review of pension legislation to be quite different. We expect this review to identify problems that exist not only with the pension standards, but also with the pension system as a whole. Moreover, we hope that this review will result in changes creating a much more favourable environment for the creation, maintenance and improvement of occupational pension plans in the interest of increasing pension coverage and retirement income adequacy, particularly for Canadian private sector workers, more than 70% of whom have no pension coverage.

We have prepared our submission to correspond with the structure of the Department's Consultation Paper. We would be pleased to meet with the Department to discuss any questions you may have about our submission.

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2. Comments on Issues for Discussion Pertaining to Defined Benefit (DB) Plans

2.1 Solvency Measurement and Funding Rules

The Government of Canada is interested in stakeholders' views regarding the rules for funding solvency deficiencies and the solvency calculation itself.

One of the main purposes of pension standards is to establish funding rules to provide reasonable assurance that members' pension promises will be honoured by advance funding outside the reach of the plan sponsor and its creditors. Due to concerns about the lack of alignment, for DB pension plans, between funding rules and surplus ownership, many plan sponsors are funding at minimum levels, which may jeopardize benefit security and increase the volatility of contributions.

A DB plan's solvency position does not have to be volatile. What creates volatility is investing plan assets in equities or equity-like investments when liabilities inherently behave like nominal or real return bonds. Pension funds invest in equities to seek additional return that is frequently required in order to make the expected cost of the plan affordable at existing benefit levels. This additional expected return comes with a price however, greater uncertainty in the ultimate cost.

The effect of volatile equity returns on pension plans has been reasonably well understood -- not welcome, but understood. To mitigate this effect, larger plans have been moving to diversify some of their conventional stock market exposure through alternative investment strategies, private equity and infrastructure.

The effect of falling bond yields was not well understood by many plan sponsors before the pension world's "perfect storm" a few years ago, when poor investment returns and a falling interest rate environment converged to cause many DB pension plans to experience what was at the time record-low solvency funding levels and, thus, record high minimum funding contribution requirements. Plan sponsors now have a much better understanding of the impact of duration mismatch in the fixed income portfolio and the financial risk that comes with investing in non-matching assets; many larger plans have now taken conscious steps to mitigate these risks. We note, however, that there is no practical way for pension plans to fully hedge inflation risk. While the real return bonds of the Government of Canada and other issuers provide a hedge against price inflation risk, they are not a practical tool on a macro level because of their limited supply and because they do not directly hedge wage inflation risk.

Based on recent research that we conducted, a typical plan's asset-liability mismatch has a roughly 10% probability of causing a change in going concern position over a three-year period of ± 25% or more. The windup position exhibits even greater volatility. This illustrates that the funding limits in the federal Income Tax Act and

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regulations (the greater of 110% of the going concern liabilities and 100% of the windup liabilities) are too low and should be increased in order to enable reasonable assurance of plan solvency.

Our recommendations below regarding minimum funding requirements aim at addressing the need to ensure solvency in a volatile economy.

Minimum funding requirements

The statutory focus of minimum funding should be benefit security now and in the future. This implies:

- A forward-looking view. For example, the standard might be an 80% probability that the plan will be fully solvent five years from now.
- Investment policy should be reflected in determining the minimum funding requirement so that asset-liability mismatch risk is considered, albeit in a simplified manner. For example, target funding levels should be higher for plans with large mismatches between assets and liabilities than for plans with small mismatches.
- The minimum funding requirement should not be dependent on the sponsor's financial strength. When minimum contributions are based on financial strength, concessions granted to a once-strong company could accelerate a slide into bankruptcy when those concessions are removed and the now-weakened sponsor must assume the burden of the additional contributions required.
- Regulatory powers to address funding concerns, such as accelerating the timing of the next actuarial valuation, should be limited and clearly detailed in legislation so that a sponsor knows what to expect.

If sponsors' concerns about the lack of alignment between funding rules and pension promise (e.g., the access to surplus issues discussed below) are resolved, the need for additional security should be met through additional contributions to the pension fund. However, letters of credit (LoCs) and contingency reserve accounts (described further below) should be made available to provide funding flexibility, without any member consent requirement. In the event that the above issues are not resolved, their availability to DB plan sponsors becomes much more important.

We believe a two-pronged approach is necessary to maintain (or enhance) the current levels of benefit security while, at the same time, addressing surplus uncertainty questions:

Letters of Credit (LoC)

LoC issuance and pricing reflect changing business circumstances. The use of LoCs is already sanctioned by Quebec, Alberta and British Columbia. If the PBSA were to permanently permit plan sponsors to obtain an LoC to secure the amount they would otherwise need to fund to liquidate the plan's solvency deficiency, plan sponsors

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would have additional flexibility in managing the funding of their DB pension plans. At the same time, the security of benefits would not be negatively affected.

While this alternative provides a suitable short-time solution in some situations, the additional cost of securing the letter of credit may prevent it from being a viable longer-term alternative for many sponsors. In addition, except for plans where the sponsor voluntarily provides an LoC amount higher than the minimum required contributions, permitting LoCs in and of itself would not improve the security of members' benefits; it would simply provide additional flexibility to plan sponsors while maintaining current levels of security.

To ensure that longer-term flexibility is readily available to plan sponsors, and to further encourage plan sponsors to improve benefit security, an additional alternative is necessary.

Contingency Reserve Accounts

A complementary approach involves the use of contingency reserve accounts. The contingency reserve account would be a new form of "rainy day cushion". Contributions required under the going concern valuation would be paid to the pension fund. Further contributions required under the solvency valuation would be paid to a special purpose trust. This contingency reserve would be tax-sheltered, held separate from the sponsor's assets and protected from non-pension creditors. Contingency reserve assets not required to meet benefit obligations on plan windup would revert to the sponsor. For an ongoing plan, the sponsor would be allowed access to the contingency reserve if the total assets of the pension fund and the reserve exceed a reasonable margin of safety that reflects the degree of mismatch between plan assets and liabilities.

The reserve could also hold voluntary contributions that would better enable sponsors to match funding to their business cycles and thereby decrease contribution volatility.

In the event of a full windup, obligations would first be charged to the pension fund and then, as required, to the contingency reserve account. If money remains in the pension fund after all obligations are met, it would be distributed as under the current regime. Contingency reserve account assets not required to meet obligations would be returned to the sponsor. If the combined assets of the pension fund and contingency reserve account are not sufficient to meet obligations, the shortfall would be addressed as under the current regime (see comments in section 2.2), except that all sponsor contributions made after the windup date to address a windup shortfall would be made to the contingency reserve account.

If the issue of surplus ownership is not clarified, DB plan sponsors will naturally continue minimum funding policies that reduce the likelihood of a large surplus developing. While reducing the likelihood of a surplus, minimum funding also reduces benefit security and increases contribution volatility.

As described above, the use of LoCs and contingency reserve accounts should be made available. In the event that surplus ownership issues are not resolved, these vehicles will become more important as effective and efficient

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ways to secure the pension promise. Otherwise, faced with escalating financial liabilities, corporate-sponsored DB plans will likely continue to disappear, and with them, the retirement income security of ever more Canadians.

Increase in Surplus Limit

With the goal of improving benefit security and allowing rainy day margins, the Department should implement tax changes raising allowable funding limits for DB plans from the current maximum of the greater of 110% of going concern liabilities and 100% of windup liabilities. The determination of the increased funding thresholds could be based on an analysis of the volatility of a typical pension plan's funded ratios. Based on the research mentioned above, we believe that the funding maxima should be raised to roughly 125% of the greater of the going concern liabilities and windup liabilities.

Special Funding Rules

Our comments above are focused on single employer DB plans. The much different nature of multi-employer defined benefit pension plans with negotiated contribution rates (i.e., contributions to such plans are limited to the negotiated amounts) may warrant different funding rules. This would also be the case for target benefit plans, if permitted (see section 4.1). However, basic funding principles should be the same, with recognition of the need to constrain the risk of having to reduce accrued benefits to a low level.

2.2 Requiring Full Funding on Voluntary Plan Termination

The Government of Canada is seeking views on whether to require that plan sponsors fully fund pension benefits when a plan is fully terminated but provide that payments can be made over a period of five years, and treat the outstanding obligation as an unsecured debt of the company. In addition, the Government is seeking views on conditions, if any, where a plan could be terminated in an underfunded position by virtue of an agreement between the sponsor and plan members.

We support the general principle that pension promises should be clearly articulated and honoured by plan sponsors. We thus support full funding on plan termination, but believe that such a requirement should not be implemented without consideration of surplus uncertainty issues. We would also support that such funding be made over a maximum period of five years and treat the outstanding obligation as an unsecured debt of the plan sponsor.

Towers Perrin believes that benefits promised by a DB plan may reasonably be regarded as deferred wages. Recent amendments to federal insolvency legislation have given a priority claim to pension contributions in respect of current service contributions due and payable on the date of insolvency. The question is, should the same principle apply to the entire amount of an unfunded wind up liability? It is clear that arguments can be made

in favour and against giving priority creditor status to all unfunded pension liabilities. On the one hand, employers might argue that giving such priority would interfere unduly with the ability to raise capital for business purposes. On the other, members might argue that pension liabilities should be awarded the same treatment as any unpaid cash compensation. It is Towers Perrin's view that extending secured-creditor status to all unfunded pension liabilities should be studied further by the Government of Canada.

With the goal of maintaining (or enhancing) the current levels of benefit security while, at the same time, addressing the surplus uncertainty question, we invite the Government of Canada to strongly consider the two-pronged approach (letters of credit and contingency reserve accounts) outlined in the section 2.1 above.

Note that multi-employer defined benefit pension plans with negotiated contribution rates should be exempt from the requirement for full funding on plan termination. Contributions to such plans are limited to the negotiated amounts.

The Surplus Uncertainty Question

There is often a lack of clarity and agreement on what the true pension promise is in a DB plan. Due to the lack of clarity, there has often been a need to revert to the courts to resolve the various claims of pension stakeholders. The resulting court decisions have created a misalignment between plan funding and the pension promise. In particular, the treatment of surplus assets has become a highly contentious issue. In most cases, plan sponsors are clearly responsible for the rapid funding of solvency deficits, but often members lay claim to any surpluses. From the perspective of sponsors, this situation creates a misalignment between the funding requirement and the pension promise (i.e., the sponsor shoulders the funding risk in the case of a deficit, but members benefit from some or all of any emerging surplus).

It is Towers Perrin's view that in a DB plan, surplus entitlement should be determined by current plan documents and clear statutory rules. We do not suggest that existing surplus rights that members may have based on historical documentation should be erased. Rather, and as recommended by the Alberta/B.C. Joint Expert Panel on Pension Standards, we support an approach that would allow plan sponsors to "ring fence" existing plans and establish new pension plans for future service that have clear surplus entitlement language. We also recommend that for all new pension plans, an amended PBSA should provide clearly that only current validly-enacted plan documents have any legal effect. This would ensure that surplus entitlement can be determined expeditiously, without the need to review historical plan documents.

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2.3 Partial Termination and Immediate Vesting

The Government of Canada is seeking views on whether to eliminate the concept of partial termination from the Act but require immediate vesting of pension benefits for all members.

We support the elimination of the concept of partial termination instead of modifying the legislation to clarify that surplus distribution is not required on partial plan terminations.

We note that the legislative circumstances giving rise to a partial termination introduce unnecessary complexity to plan administration due to their vagueness. In addition, the arbitrariness of treatment of a plan member affected by a partial termination and a plan member who is terminated under other circumstances under the legislation is difficult to justify on policy grounds. We therefore support the elimination of partial terminations as a legislative concept.

If partial terminations are eliminated, we would support the introduction of immediate vesting of benefits of terminated plan members. Introducing immediate vesting would serve positive policy aims:

- Plan members affected by a transaction that would, in the past, have given rise to a partial termination would retain the protection provided by current legislation; and
- The protection of benefits referred to above would be provided to all terminated plan members, regardless of circumstances of termination, which is in our view a more equitable outcome.

2.4 Disclosure of Information

The Government of Canada is seeking views on whether to:

- ***Require administrators to establish a Statement of Funding Policy (SFP) in a similar fashion as the Statement of Investment Policies & Procedures (SIP&P). The SFP would be examinable upon request, like the SIP&P.***
- ***Allow required disclosure items to be disseminated by electronic means, at the option of the receiving member or beneficiary.***
- ***Expand the categories of members required to receive plan information to include former members and retirees, where it is appropriate.***

As a result of several factors, not the least of which is the surplus uncertainty question, most DB plan sponsors elect to fund at the statutory minimum levels. Accordingly, until the surplus uncertainty question is addressed, it

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is highly unlikely that plan sponsors would adopt a funding policy requiring funding in excess of the statutory minima.

Assuming the surplus uncertainty question was addressed, we encourage all plan sponsors to adopt a funding policy. However, we oppose such document becoming mandated by legislation for the reason outlined below.

In the single employer plan context, the law has historically maintained a distinction between the functions of the employer in its capacity as sponsor of the plan and in its capacity as administrator. An employer acting in its capacity as plan administrator stands in a fiduciary relationship towards plan members, and a comprehensive legislative reporting and compliance regime exists to ensure that this standard is met. By contrast, an employer acting in its capacity as plan sponsor is permitted to make decisions in its own best business interests, with the requirement only to act in good faith vis-à-vis the plan members. We note that the Supreme Court of Canada has explicitly recognized that employers establish pension plans for business reasons (e.g. to compete effectively in labour markets) and that employers' "business interests" must be taken into account for purposes of "the legislative objective of encouraging the establishment and maintenance of private pension plans".[1]

The employer, in making its deliberations regarding the manner and extent to which it funds its pension plan, does so in its capacity as the sponsor of the plan; that is, such decisions are dictated in large part by the employer's own interests, subject to the minimum funding standards of pension legislation. To the extent that this is the case, we do not think it is appropriate to require a plan sponsor to formalize its discretion to fund the plan within the limits of the law in a document such as the SFP, and for such a document to ultimately be made available to the regulator and membership of the plan. Such a document would unnecessarily fetter an employer's ability to fund the plan as it sees fit and as changing circumstances dictate, subject to legislated minimum funding requirements.

By contrast, once a funding decision has been made and contributions remitted to the pension fund, the employer, when dealing with the plan assets in its capacity as plan administrator, is required to act in the best interests of the members, not its own. The legislative purpose of a SIP&P is to ensure that the investment policy and procedures of the pension fund are clearly and transparently articulated and diligently implemented. The same considerations do not exist to justify the requirement of an SFP, for reasons stated above.

The distinction above is best illustrated by analogy to the plan amendment process. A plan sponsor, when deliberating whether to amend a pension plan to increase or reduce benefits is not expected to disclose such deliberations nor is it required to circumscribe or fetter its discretion to amend the plan through a policy document mandated by legislation. However, once the decision has been made to implement the amendment, the minimum legislative standards exist to ensure that such an amendment is both permissible and implemented with appropriate notice to plan members.

[1] See *Buschau v. Rogers Communications Inc.*, 2006 SCC 28 at para. 97.

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We agree that disclosure should be encouraged so that plan members have a better understanding of what their benefits are, how the pension deal is intended to work and the degree to which their benefits are subject to risk. However, such additional information should not result in unreasonable administrative expenses. Annual pension statements, bulletins or displays on the plan sponsor's website could be used to communicate additional information.

We therefore support the use of electronic means not only to provide members with greater access to information but also as a way to transmit required annual information such as annual pension statements. Also, as an alternative to providing this information in annual pension disclosure, plan sponsors should be also permitted to provide members with access to pension modeling tools that can produce the same, or similar, information.

We would also support the use of a plan sponsor's website as a means to communicate general information on the pension plan to former members and retirees but we oppose a more stringent requirement as it would likely result in unreasonable administrative expenses.

2.5 Contribution Holidays

The Government of Canada is seeking views on whether:

- ***Plan sponsors be required to develop a formal policy on contribution holidays for inclusion in a Statement of Funding Policy; and***
- ***To the extent that employer contributions are permitted under the tax rules, plan sponsors only be permitted to take a contribution holiday in the year in which a valuation report, filed with OSFI, shows a surplus in the plan on a solvency basis.***

We do not see the need to require a formal policy on contribution holidays as circumstances affecting a plan sponsor may change. In certain situations, such a policy could unnecessarily deprive plan sponsors of flexibility in determining appropriate funding levels.

We would support a requirement to file with OSFI an actuarial opinion rather than a full valuation report to justify a contribution holiday in a year between triennial valuation years. Such actuarial opinion would disclose the estimated surplus in the plan on a solvency basis in order to justify a contribution holiday in the given year. The surplus estimate disclosed in the actuarial opinion would be based on projection of the liabilities disclosed in the last filed valuation report, with adjustment for the current economic environment, and would reflect the actual asset value.

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2.6 Void Amendments

The Government of Canada is seeking views on whether to amend the regulations to prescribe a solvency ratio level of 0.85 for the purpose of implementing the void amendment provision in the Act.

For single employer pension plans, we continue to disagree with the establishment of a solvency threshold for benefit improvements. We maintain that the combination of three requirements should suffice to protect plan members:

- Full funding on plan wind-up;
- Retroactive voiding of unfunded improvements upon wind-up in a chronological order; and
- Clear disclosure to plan members of the funded position of the plan and the inherent risk of a solvency deficit.

If the concept of a prescribed solvency ratio is adopted, pension plans should be permitted to make plan improvements provided that offsetting funding is provided at the time that the improvement comes into effect to maintain the plan's solvency ratio at the prescribed level (or to fund 100% of the additional solvency liability, if less).

We note that the "void amendment" concept appears to be inconsistent with the treatment of newly established plans that provide retroactive past service to plan members.

We also note that the "void amendment" concept imposes restrictions on the collective bargaining process. The negotiation process could last several months during which time the solvency ratio of a plan could change drastically. The "void amendment" concept would affect the ability of the plan sponsor to budget for the negotiated plan improvements.

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3. Comments on Issues for Discussion Pertaining to Defined Contribution Plans

3.1 Safe Harbour Protection for Qualified Default Investment Options

The Government of Canada is seeking views on the practicality and desirability of safe harbour protection, and what considerations should be made in the determination of the qualified default investment options.

We believe that providing a "safe harbour" protection for plan administrators in setting a default investment option that meets enumerated criteria set by regulation could promote expansion of the pension system and potentially serve to improve the adequacy of pension plan benefits.

We support the use of broad, but meaningful criteria to circumscribe the range of appropriate funds for the purposes of the default investment option, so long as such criteria are clear and objective. In our view, excessively vague criteria could give rise to litigation concerning whether a given default investment option falls within the statutory "safe harbour", thereby defeating its purpose.

We recommend that the Department articulate the circumstances under which usage of the default option would be considered appropriate and could include the following:

- Where participants fail to elect investment options upon enrolment in the plan,
- Where an investment option is removed from the plan and participants fail to elect a new investment direction for continuing deposits or fail to elect a new investment option for the funds invested in the terminated investment option, and
- Where plan assets are transferred between carriers and participants fail to submit new investment directions for existing assets and/or future contributions.

We recommend that protection should be given to plan sponsors and administrators where:

- Compliance with pension legislation has been demonstrated, or
- The claimant has failed to demonstrate non-compliance.

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3.2 Retirement Benefits Paid from the Pension Fund

The Government of Canada is seeking views on whether to allow the payment of variable retirement benefits directly from the defined contribution account.

We fully support amendments to pension legislation that would allow DC plans to offer variable disbursement options. These options could include variable payments currently permitted under a life income fund and other types of flexible disbursement arrangements. However, offering such variable disbursements should always remain at the plan sponsor's option; the ability to receive variable disbursements from a DC plan should not be a plan member's right, considering the significant additional administration it would involve.

3.3 Standard of Care Changes

The Government of Canada is seeking views on whether it is appropriate to revise the standard of care for employers sponsoring defined contribution plans to "good faith" rather than "fiduciary".

We continue to see significant improvements in DC plan governance practice since the Canadian Association of Pension Supervisory Authorities issued Guidelines for Capital Accumulation Plans (the "CAP Guidelines") in 2004. The CAP Guidelines have helped DC plan sponsors to do a better job in terms of plan administration and governance.. We therefore support the recommendation to legislate a "good faith", rather than fiduciary, standard of care upon the administrator of a DC plan. Such a standard would be consistent with the nature of a defined contribution arrangement, pursuant to which the investment risk and ultimate responsibility for the benefit payable from the arrangement is borne by the member.

We do not view adoption of a "good faith" standard of care as a relaxation of standards for plan governance. We believe that proper plan governance, together with the existing legislative requirements such as those concerning the remittance of contributions to the plan and disclosure to members, would be sufficient in conjunction with a "good faith" standard to ensure that plan members' interests are adequately protected. We also believe that the introduction of the "good faith" standard would be another incentive for plan sponsors to consider setting up DC plans instead of group RRSPs or deferred profit sharing plans, which provide less protection for plan members because they are not subject to the PBSA.

We note that an independent, actionable duty of care has been imposed on plan administrators by the courts by operation of common law and trust law. In the event that a "good faith" standard is enacted in the legislation, we strongly recommend that such legislation make clear that the statutory standard would override any other standard developed by the courts, either in common law or in equity. In the absence of such a stipulation, it is not clear what effect, if any, such a legislative measure would have in ensuring that defined contribution plan sponsors are not subject to the more-onerous fiduciary standard.

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3.4 Use of Surplus in Defined Contribution Plan Components

The Government of Canada is seeking views on whether it is appropriate to clarify that defined benefit surplus can be used to offset employer's defined contribution current service costs for hybrid plans.

A growing number of employers sponsor pension plans containing both defined benefit and defined contribution components or are in the process of modifying existing arrangements to contain both provisions. Where actuarial surplus exists in the defined benefit component of such a plan, employers typically desire the flexibility to deploy such surplus for the purpose of funding current service costs in the defined contribution component of the plan. Unfortunately, recent judicial decisions have introduced uncertainty as to whether an employer may validly make use of actuarial surplus in such manner.

We therefore recommend amendments to the legislation to clarify an employer's ability to use actuarial surplus in the defined benefit component of a pension plan to fund current contributions to the defined contribution component. Contribution holidays are usually permissible under a defined benefit plan, despite the fact that the class of beneficiaries of the plan is seldom fixed; members are added to and leave the plan throughout its existence. By the same reasoning, we think that it is artificial to create a division between members of the defined benefit component of a hybrid plan and those in the defined contribution component and there is no policy reason to maintain such a distinction. We observe that in many cases, the same individuals may have coverage under both the defined benefit and the defined contribution component of a pension plan (e.g., where the plan design provides a combination of defined benefit and defined contribution coverage for future service, or when the plan design provides defined benefit coverage for past service and defined contribution coverage for future service).

3.5 Administrative Procedures

The Government of Canada is seeking views on required administrative practices that may impede the proper and efficient administration of defined contribution plans.

We support the recommendation to allow for an automatic transfer of the account balance of a terminated plan member to a pre-determined alternative tax-deferred savings account outside of the plan in the event an election is not made. The legislation does not currently prescribe a default option a plan administrator can avail itself of on behalf of a terminated plan member or spouse of a deceased member in the event an election is not made. Permitting the transfer of the balance to an account outside of the plan, provided that notice requirements of the legislation are met, will avoid additional unwarranted costs to the plan sponsor for administering such balances.

We support the introduction of additional options for members of defined contribution pension plans to access their pension monies, provided that the proposed options are transparent and not overly complex to administer. If

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unlocking is permitted on grounds of financial hardship, we strongly recommend that the administration of such unlocking be done through the regulator after the pension funds have been transferred out of the pension plan, as in Ontario. Requiring plan administrators to shoulder the cost and responsibility of administering financial hardship unlocking would be unduly onerous and undesirable.

Locking-in has been hotly debated in recent years and several jurisdictions have introduced measures that relax this policy. We encourage the Government of Canada to consider the merits of locking-in relative to the complexities involved in administering locked-in accounts. At a minimum, while current rules can be simplified, pension plans must, at the discretion of the plan sponsor, continue to be allowed to lock in benefits during, as well as after, employment with the participating organizations.

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4. Comments on Other Issues Respecting the Framework for Private Pension Plans

4.1 Flexibility of the *Pension Benefits Standards Act, 1985*

The Government of Canada is seeking views on whether there is interest in alternative plan designs that may not currently be accommodated by the legislative framework.

Pension legislation needs to be sufficiently flexible to accommodate changing objectives and designs. Not offering such flexibility will impede the expansion of pension coverage. In general, we recommend that the legislation be adaptable in order to accommodate the continuously-evolving arena of pension plan design. For example, below we describe an alternative plan design that should be accommodated within the legislation.

Target Benefit Plan

This is an alternative approach in which legislation would allow a sponsor to offer a plan in which it commits to make fixed contributions aimed at funding a target retirement income, but does not guarantee that the target level will be delivered. Ancillary benefits and accrued benefits could be reduced or member contributions may increase in the event of adverse experience – a risk that must be clearly communicated to plan members. This type of plan would operate under rules appropriate to multi-employer pension plans, but would not require the involvement of multiple employers or necessarily be subject to a collective agreement. As risk is borne by the membership, intergenerational equity would be an important objective for such plans. This approach is similar to member-funded plans in Quebec.

4.2 Multi-Employer Pension Plans (MEPPs)

The Government of Canada is seeking views on whether there are legislative impediments to the creation or operation of multi-employer pension plans, and if there are improvements that could usefully be made to the legislative framework for these arrangements.

We think that government policy and legislation should encourage the adoption of a new form of MEPP. This type of arrangement should:

- Be open to many employers in different industries;
- Have an expert board of trustees that would set investment policy and overall contribution rates;
- Have each employer decide how it will split the contribution requirement with its employees;

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- Design the plan to avoid any potential for subsidies between employers based on factors within their control;
- Be designed and financed so as to best achieve equity between different generations of members and employers; and
- Pool longevity risks and the running costs of the plan, but nothing else.

In order to provide sufficient scale, such a plan would likely need to be sponsored by a government agency or a large financial institution. Centralized administration, investment, and communication functions would enable participation by small and medium-sized employers.

4.3 Simplified Pension Plans

The Government of Canada is seeking views on the relevance of Simplified Pension Plans, and whether there are any impediments in the legislation to the adoption of such arrangements.

We are not aware of any impediments in the legislation.

4.4 Distinction between Defined Contribution and Defined Benefit Pension Plans under the Act

The Government of Canada is seeking views on the appropriateness of reorganising the Act to provide greater clarity on the differing legislative provisions applicable to defined benefit and defined contribution plans. Specific examples of legislative impediments and uncertainties are particularly desired.

We support the adoption of legislation distinguishing between defined benefit and defined contribution plans. The provisions of the current legislation, geared towards traditional defined benefit plans, are not well-suited to defined contribution plans, and introduce a layer of unnecessary complexity to their administration. In particular, we think that the following provisions can be simplified/eliminated with respect to defined contribution plans:

- the concept of retirement dates is not necessary for defined contribution arrangements, with the exception of a minimum age at which funds can be disbursed to a member (i.e. an “early retirement date”); a member’s account need simply be distributed upon termination or death and the proceeds used to purchase an annuity or invested in a locked-in vehicle permitted by legislation; and
- pre-retirement death benefit rules should be simplified, simply permitting the account balance to devolve to the member’s survivor; the mandatory joint and survivor form should be preserved in the event an annuity is purchased by a member on termination.

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4.5 Investment Rules

The Government of Canada is seeking views on ways to improve the regulatory framework governing pension investment.

The investment environment is continuously evolving. Many sound investment vehicles and products that were unheard of ten years ago are now readily available. Pension legislation must be sufficiently flexible to accommodate existing investment instruments and those which may become available in the future. A rules-based approach to investment regulation cannot be sufficiently fluid to remain up-to-date. Accordingly, we recommend that principles-based approach, underpinned by the “prudent person” standard of care. We note that virtually all developed countries have moved in this direction.

We further recommend that the quantitative limits incorporated in the current investment rules be eliminated. Such limits should be unnecessary in a regulatory environment that imposes a “prudent person” standard of care. Quantitative limits can also impede a pension plan administrators' ability to benefit from the evolving investment markets.

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