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Ms. Diane Lafleur  
Financial Sector Policy Branch  
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Dear Ms. Lafleur:

**Re: Comments on Federal PBSA Consultation Paper**

We are pleased to submit our comments on the consultation paper released January 2009 calling for the strengthening of the legislative and regulatory framework for private pension plans subject to the Pension Benefits Standards Act (PBSA). Our comments are based on our experience as actuarial consultants to sponsors of federally regulated pension plans and pension plans in other Canadian jurisdictions, but do not necessarily represent the views of other actuaries and pension consultants with our employer, Eckler Ltd.

**Introduction**

There are two basic principles that underlie all of our comments on the consultation paper:

1. Private pension plans should be encouraged by the federal government.
2. Employers and active members should be provided with enough flexibility to determine their pension deal, and allow for changes to that deal as the economic environment changes. Retired members should be protected from changes to their retirement benefits.

Several decades ago, private pension plans were established in large numbers, partly because tax-advantages were given to sponsors to establish them and to plan members. We lament that we are seeing the closing of many of those pension plans due to the prescriptive nature of the rules governing them. In our view, providing additional tax-advantages to employees and encouraging employers to sponsor defined benefit or target benefit pension plans would benefit Canadians as a whole. Increasing coverage under these plans will lower government expenditures down the road if future retirees can rely on private pension plan income, rather than publicly financed support programs, in their old age.

One example of tax-disadvantages of a registered defined benefit (DB) pension plan is the current Pension Adjustment (PA) multiplier of 9. We all know that a DB pension plan is worth less at younger ages, so why not use an age graded PA multiplier? For example, use a PA multiplier of 1 for active DB pension plan members under age 20, increasing by 1 every 5 years, to 9 for active DB pension plan members age 60 or over.

In fact, we note that the PA factor of 9 was developed over 20 years ago, at a time when real return interest rates were much higher than exists in the current economic climate. We believe that the PA factors are overdue to be updated to reflect the current level of interest rates, both nominal and real.

And why not eliminate the maximum transfer limit rules in Section 8517 of the Income Tax Regulations, provided the DB lifetime and bridge pensions are limited to the CRA maximum, and the commuted value is calculated based on factors prescribed by the Canadian Institute of Actuaries?

Also, prohibiting employer DB pension plan contributions when assets exceed 110% of the liabilities also does not make sense. The threshold should be at least 125%.

Under a DC plan or a MEPP, the recent market losses must be borne by members. With the current 18% contribution limit, such individuals have little, if any, ability to increase their retirement savings to try to recover from these losses. The only alternative is to accept the substantial investment losses. We recommend consideration be given to increasing the contribution limit to provide such individuals the ability to increase their retirement savings to offset these large investment losses.

We strongly urge the federal government to use its taxation powers to encourage the development of pension plans. The ability to save on a personal basis through RRSPs and through occupational pension plans would bode well for Canada. We have become a nation of debtors rather than savers, with the savings rate shamefully low. This can be reversed through added tax incentives by the federal government.

In the following sections of our response we will address your specific questions.

### **Question 1**

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

The experience of private pension plans in the past decade highlights the problem with solvency valuations in their current structure. As pointed out in the consultation paper, relief from solvency rules needed to be provided to plan sponsors twice in the past few years so that workplaces could continue to function and employees would keep their jobs. The fact that the solvency rules do not properly function in the current environment leads us to conclude that permanent changes need to be made.

Why not eliminate solvency funding requirements altogether? Instead of arbitrary solvency funding rules, why not require each plan to have a clear ongoing funding policy with respect to their going-concern valuation, with full disclosure of that policy to the plan members? To improve benefit security, and discourage dysfunctional behaviour, require benefit improvements to be funded over a shorter period of time (such as 5 years, or the duration of a collective agreement if shorter, or immediately if less than 85% funded).

In our view, some of the under-funding in pension plans is due to the under-appreciation by employers and employees of the cost of the benefits being promised to employees. Some of the under-funding is also due to the way past service benefit enhancements in flat-dollar plans are amortized over long periods of time (up to 15 years). A funding policy will help with this understanding and quicker amortizations of benefit improvements will help to ensure plans do not over-promise.

Eliminating solvency valuations will also reduce the volatility of the plan sponsor funding requirements. Hypothetical windup valuations, including all promised benefits, should continue to be disclosed to plan members.

Alternative ways to balance the current solvency funding burden, while ensuring benefit security upon plan wind-up, include:

1. Allowing solvency payments to be funded by letters of credit, or by pension security trusts;
2. Increasing the solvency deficiency payment amortization period;
3. Continuing the use of smoothed assets, with the potential to smooth liabilities; and
4. Excluding post-retirement indexing from solvency liabilities.

If solvency funding is kept for single-employer pension plans, we believe that multi-employer pension plans (MEPPs) should be exempt from solvency funding, since a going-concern valuation is a more appropriate measure due to their characteristics. In particular, MEPP's are far less at financial risk if an employer ceases its participation in the MEPP (either voluntarily or through bankruptcy). Further, plan members bear all the risks of the plan. Therefore, solvency funding results in greatly increased volatility of the plan's benefit levels rather than providing benefit security.

## **Question 2**

**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.**

In our view, it seems logical that an employer fund the benefits it has promised its members on the voluntary termination of its pension plan. However, circumstances may arise where it is in the mutual interest of the employer and employees to trade the pension benefit funding for other considerations. Thus, we support the ability for the employer and plan members to come to a negotiated agreement on funding deficits on plan termination.

If jointly-sponsored target benefit plans are a permissible plan design (which we recommend, as noted later in this submission), whereby employers and members agree to a fixed level of contributions, inherent in the target benefit plan design is the ability to reduce benefits upon plan termination in an under-funded position.

### **Question 3**

**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 fully support the removal of partial terminations from pension legislation. This would confirm that surplus is not to be distributed before a full plan windup. As noted by many others, surplus distribution during the plan's operations that has not been mutually agreed to by the employer and members puts the members remaining in the plan at risk by removing some of the buffer for future adverse experience.

We do not support immediate vesting for all terminations. Many federally regulated employers have significant turnover in the first few months of employment. Under MEPPs, it is common for members to participate in a plan for very short periods of time (e.g., just the summer months under construction trades). As a result, these individuals would have very small pension benefits and do not typically continue to work in the industry. Immediate vesting would increase the administrative burden with little benefit for the affected members. Also, we believe that there will be a much larger number of "orphaned" deferred vested benefits remaining in the plan indefinitely for terminated employees that cannot be located.

We suggest two alternatives: either reduce the minimum vesting period from two years to one year, or require immediate vesting if a large group of members are terminated (e.g. more than 10% of the workforce).

#### **Question 4**

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 noted in the section above on solvency funding, we fully support the requirement for plan sponsors to develop a Statement of Funding Policy (SFP) as part of its governance process. Such a policy will ensure that the parties to the pension deal understand, in advance of surplus or deficits arising, how they will be treated. The SFP should be disclosed to plan members, and could be developed in conjunction with pension committees. Drafting the SFP in conjunction with plan members would certainly reduce litigation risk.

We support the ability for members to elect electronic distribution of disclosure items.

The consultation paper suggests that retirees receive similar information as actives. One way to ensure all plan members receive meaningful information is for administrators to provide an annual report, similar to those already undertaken by some pension plans, with information on asset performance, the funded status of the plan and other pertinent information.

#### **Question 5**

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.***

The consultation paper suggests that it might be prudent for plan sponsors to take contribution holidays only in the year in which a valuation report is filed with the Superintendent. This idea could be modified to require plan sponsors to file valuation reports annually. Over the past several years, many plan sponsors have filed annual reports because the solvency ratio of their plans has been less than 100%. Although recommending annual valuations may seem at first glance to be self serving, producing annual reports would very quickly commoditize this process

(similar to annual audits of pension plan assets), and the additional benefits in terms of disclosure and security would very quickly outweigh the additional cost.

Requiring annual valuation reports when pension plans are in surplus is not much more onerous. Most sponsors prepare internal valuations for information purposes, so the cost is already being borne. Annual calculations are also prepared with respect to accounting valuations for the purpose of reporting on a sponsor's financial statements. If solvency valuations are eliminated, or their funding requirements lessened, as we suggested, preparing annual valuations will not increase volatility in employer contributions, and will give plan members access to information on the status of their pension plans financial status through the regulatory filings.

As noted above, we support the requirement that the treatment of contribution holidays be set out in a plan's Statement of Funding Policy.

### **Question 6**

**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.**

We do not have an issue with instituting restrictions on benefit improvements where the plan's solvency ratio is less than 85%. We do note that, starting in 2011, publicly traded plan sponsors will be subject to International Accounting Standards. These standards will require companies to recognize benefit improvements immediately in their current year's accounting expense, and on their balance sheet, providing another deterrent to unfunded benefit improvements.

We disagree with this concept in respect of MEPPs. MEPP trustees may seek additional contributions from members to address any shortfall. It may be difficult for members to agree to increase contributions with no associated increase in benefits. We suggest that, for MEPPs, benefit improvements be permitted, but perhaps with a shorter amortization period (say 10 years).

### **Question 7**

**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.**

If plan sponsors are considered fiduciaries (see further detail on fiduciaries in our response to question 9), we do encourage safe harbour protection for them if they follow certain rules, since the protection will encourage employers to establish DC pension plans for retirement purposes (versus RRSPs, which have lots of other purposes).

However, the safe harbour should provide flexibility in a DC plan to help ensure that it best meets the needs of its members through various types of economic and investment markets – as well as individual financial circumstances. If the safe harbour protection is in respect to the

default investment option, the safe harbour option should be allowed to be either Asset Allocation funds, Target Date funds, Balanced funds or some other fund designed to meet members' long-term investment needs.

### **Question 8**

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

We do not see any practical reason to prohibit the payment of variable retirement benefits directly from the defined contribution account. In fact, keeping members' retirement assets within a DC plan will likely reduce the investment management fees the retiree would need to pay otherwise, and could potentially reduce active members' fees as well.

### **Question 9**

**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'.**

This is mainly a legal question, so input from pension lawyers is required. From a consulting perspective, any change that encourages employers to establish DC pension plans for retirement purposes (versus RRSPs, which have lots of other purposes) is a change we encourage.

As an alternative to defining the plan sponsor's standard of care for a DC pension plan, it may be more helpful to address the roles of the plan sponsor and the member within the Pension Benefits Standards Act, as has been done in the Capital Accumulation Plan Guidelines published by the Joint Forum of Financial Market Regulators in 2004. Clear definition of each party's role would mitigate the legal risk that is trying to be resolved.

### **Question 10**

**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.**

We support clarification of the rules on the use of DB surplus to be used for DC current service cost contributions.

### **Question 11**

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

We question whether an Annual Information Return, with associated fees, is required for a DC pension plan. Furthermore, we question whether an annual audit is required. Group RRSPs and DPSPs do not have similar requirements. If the goal is to expand and improve retirement savings, it would not seem to be appropriate to burden a DC pension plan with these additional costs.

### **Question 12**

**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.**

The consultation paper suggests that the PBSA is flexible enough to accommodate several different plan designs. One design that was not mentioned, and that we believe has great merit, is the jointly-governed target benefit plan, such as those recommended by expert panels in Ontario, Nova Scotia and British Columbia/Alberta.

For plan members, target benefit plans work much like a DB pension plan, where pensions are determined by a formula, assets are invested on an aggregate basis not tied to an individual's investment performance, and mortality risk is pooled.

For employers, target benefit plans work much like a DC plan since there is a fixed schedule of employer contributions, effectively eliminating the contribution volatility and risk associated with DB plans.

If assets are insufficient to meet liabilities, benefits must be reduced. Due to this mechanism, three safeguards are required:

1. Plan members have a significant role in the plan's governance,
2. Comprehensive member communications be required to all individuals with benefit entitlements under the plan; and
3. A strong Statement of Funding Policy be required, and conservative actuarial assumptions should be used so that deficits are not the norm.

Another benefit of target benefit plans is that issues over surplus disappear since any surplus would be used to provide a buffer against future adverse experience, or used to improve member benefits.

There are a few additional features that should be included in legislation for target benefit plans:

- Such plans should be exempt from solvency funding to allow for a predictable level of benefits for employees;
- To accommodate the target nature of the benefit (i.e., that the benefit levels can be adjusted up and down), the tax treatment should be the same as is required of Specified Multi-Employer Pension Plans (SMEPPs);
- Existing DB pension plans should be able to transition fully to a target benefit plan, allowing for reduction to previously accrued DB benefits for active members, on one of the following two bases:
  1. The members and employer agree to this as of the date of conversion, or
  2. The employer agrees to fund all special payments established at the date of conversion for their entire amortization period, without the ability to reduce either the amount or length of the amortization period through actuarial gains. Future valuations would take into account these future contributions when determining the position of the plan and whether benefits need to be reduced.

### **Question 13**

**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.**

As noted elsewhere, we recommend the creation of distinct legislation for MEPPs, so that it is very clear that:

- benefits can be reduced;
- MEPPs that are permitted to reduce benefits are subject to the same tax treatments as are afforded to SMEPPs;
- solvency funding is not required;
- surplus goes to plan members; and
- employer contributions are capped.

### **Question 14**

**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.**

The main reason you do not see many Simplified Pension Plans at the present time is that there are not many new registered pension plans being established. Once the impediments to establishing a registered pension plan are removed, we are sure that the Simplified Pension Plan rules will be more widely used.

### **Question 15**

**The Government of Canada is seeking views on the appropriateness of reorganizing 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 creating distinct legislation for DB plans, DC plans and for target benefit/multi-employer plans. Clarity of such legislation is imperative. It is fair to say that many pension disputes, some of which end up in court, results from the fact that pension legislation is not clear. The Marine Atlantic case is one illustration. Well crafted legislation would not lead to misunderstandings of our legislators' intent.

Plan sponsors and members would appreciate knowing the boundaries under which pension plans are governed. Well crafted legislation would lead to greater harmony between plan sponsors and members, lessen litigation and allow sponsors and members to forge ahead with a "pension deal" that each side is comfortable with, given the constraints of clear legislation.

### **Question 16**

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

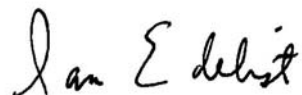
In general, there should be a greater emphasis placed on overall governance of a DB plan within the PBSA and less emphasis on a list of permitted investments for these types of plans. Specific limits on different types of investments should be removed altogether. For instance, the current rules, that prohibit 100% ownership of a business, need modification to conform to the current realities of private equity investment (i.e. the Ontario Teachers proposed purchase of BCE). For comparison, the types of prescribed limits found in the PBSA are not found in the U.S., which is governed by the Employee Retirement Security Act of 1974 (ERISA). The emphasis of ERISA is one of prudence and acting in the best interests of the plan, but it leaves it open for the Trustees of the plan to determine the appropriate mix and type of assets required to meet these goals. Moreover, ERISA reflects the fact that markets and investment products evolve over time to meet specific needs, and any prescribed list can quickly become dated and an impediment to important investment decisions. We would recommend that the PBSA adopt a similar approach on pension investment.

We appreciate this opportunity to provide input and would be pleased to discuss in more detail any of the points made in our response.

Sincerely,



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