

February 26, 2009

PRIVATE & CONFIDENTIAL

The Honourable Dwight Duncan
Minister of Finance
Attention: Comments on Report of the Expert Commission on Pensions
c/o Pension and Income Security Policy Branch
5th Floor, Frost Building South
7 Queen's Park Crescent
Toronto, Ontario
M7A 1Y7

**RE: FEEDBACK AND COMMENTARY ON THE NOVEMBER 2008 REPORT OF THE
EXPERT COMMISSION ON PENSIONS**

Dear Minister Duncan:

Introduction

On behalf of Aon Consulting ("Aon"), I am pleased to provide feedback and commentary on the Report of the Expert Commission on Pensions titled "*A Fine Balance*" (the "Report") which was released to the public on November 20, 2008.

Aon is a leading human capital consulting and employee benefit outsourcing firm. With more than 800 professionals in 14 offices across Canada, we collaborate with over 40,000 colleagues across 500 offices in 120 countries to link people strategies with business strategies to enable our clients toward excellence in performance in the areas of Retirement Strategies, Health Strategies, Human Capital Consulting and Employee Benefits Outsourcing.

Though I present this submission on behalf of Aon, it does not represent a corporate position. Rather, it is a synthesis of practitioner views that we hope will be useful to the Ontario government. While the views expressed here are generally reflective of the opinions of Aon staff who work closely with the Pension Benefits Act (Ontario) ("PBA"), the opinions of individuals may vary from what is stated herein.

Aon applauds the efforts expended by the Expert Commission in producing this report. The task which they faced was monumental and the ability of Professor Arthurs to absorb and compile massive amounts of information presented to him and then produce the voluminous report with its 144 recommendations was an outstanding accomplishment by any measure.

General Overview

A report of this kind has been long overdue and Professor Arthurs quite properly comments on the history and the significant and unforeseen events that have befallen us in the 20+ years since the current version of the PBA was enacted.

Before we comment on any of the specific recommendations, it is imperative that we discuss one significant overriding concern. This concern relates to a point which was beyond the mandate charged to the Expert Commission (to focus on the Ontario context) but which was highlighted in the Report.

There has been no consideration of big picture solutions to Canada's pension problems, the most obvious of which is the idea of a national pension system and regulator similar to what exists in the U.S.

A national pension system would have tremendous advantages for multi-provincial plan sponsors. It would allow for consistency in benefits administration and would assist in containing the costs associated with administering a pension plan.

Political egos need to be set aside to accomplish this, but it can be done if the will is there. This is where Ontario, as the largest and arguably the most powerful province, can lead the way.

This move is not unique to pensions. We face the same awkwardness with our lack of a national system for securities regulation and with multiple stock exchanges. We note that, at the time of this response, the pursuit of a national system for security regulation has already commenced.

If politicians want to attract business to their jurisdiction, they need to make the environment attractive in all respects. As wages and benefits are critical components at the most basic levels, it would seem that efforts to remove any perceived impediments should be at the forefront of political thinking – and make no mistake about it, as practicing advisors in the field, we can assure you that the pension quagmire, related to DB plans in particular, is an impediment.

As you are also aware, Mr. Minister, several other provincial jurisdictions have recently undertaken similar initiatives in terms of expert commission reports. These include Nova Scotia and the joint initiative of Alberta and British Columbia (BC). It is particularly important to point out that the joint Alberta/BC report stated that their two provinces should deal with pension plans under a single common pension act for those two provinces. We commend Alberta and BC for recognizing and acting upon this issue to the extent they can.

It is well understood that any initiative to either cede power or attempt to effect constitutional change is not a simple task and would require well thought out transitional challenges. However, as the Report notes, there is precedent to this vis-à-vis the creation of the Canada Pension Plan. Moreover, as previously mentioned, this idea is currently being pursued with respect to a single national security regulator.

Ontario can demonstrate great leadership by coordinating its initiatives with the Alberta/BC initiative and pushing toward the formation of a national pension system. We would be pleased to discuss this further with you at your convenience.

It is understood that until such time as a national or single regulator can be implemented, the focus may be on the PBA and the implementation of many of the recommendations suggested in the Report.

In the next section, we have provided comments on the recommendations put forward in the Report. These comments have particular meaning in the realm of the single employer pension plan or “SEPP” as referred to in the Report.

Commentary on Specific Report Recommendations

Chapter Four – Funding

- ◆ Recommendations 4-1 through 4-7
 - No material disagreement, although it is unclear why the filing deadline of a regular valuation report should be reduced from 9 months to 6 months in light of recommendations for Superintendent discretion to require interim accelerated valuation for plans deemed at risk of failure.

- ◆ Recommendations 4-8 through 4-12
 - General agreement, however, the concept of Jointly Governed Target Benefit Pension Plans should certainly extend beyond situations where a union exists.

- ◆ Recommendation 4-13
 - What has become clear in the last year is that the current system of going concern and solvency funding rules don't work. The concept of solvency funding was developed in a time when interest rates were high and solvency liabilities were much less than going concern liabilities. The likelihood of a DB plan member losing his/her pension entitlement is small, but the impact to the member is huge. The solution offered to date for this “problem” is to throw money at it, money that may no longer be needed when conditions reverse themselves. Typically, we would use some form of insurance to protect against this kind of loss (our reference to “insurance” is illustrative and we do not promote government-based pension guarantee funds).

One of the highlights of the BC/Alberta Report's commentary on funding deficits is the report's statement that “the test and the remedy are two separate issues.” This observation is spot on. Solvency valuations are appropriate and necessary tests for the administration of pension

plans to understand what they are dealing with; and where “solvency” and “wind up” are different, wind up valuations are equally important. We support the movement towards the acceptance of financial instruments, such as letters of credit, as an asset in determining the solvency funded position. This is a superior approach to using letters of credit as a surrogate for cash funding, which has been the focus of most regulation to date.

- ◆ Recommendations 4-14 and 4-15

- The concept of varying amortization periods based on degree of insolvency and the security margin concept are acceptable in principle. However, we see nothing magical in terms of the margin being at 5% nor the extension period for solvency valuation going to 8 years. In fact, if we go back to first principles, the solvency valuation is the security margin and therefore it seems punitive to require further margins to it. It is further presumed that there would be a “steady state” zone, say $\pm 5\%$ of neither contribution holidays nor solvency special payment requirements.

Moreover, to the extent a sponsor has been following a sound asset/liability governance structure, then some latitude should be provided against strict application of any new minimum standard such as the one proposed here. This would dovetail well with the Report's overall view towards a principles-based framework.

- ◆ Recommendation 4-16

- This recommendation is not likely to materially alter the current quagmire relating to surplus ownership and distribution. While we appreciate the Report's compromise approach, we do not believe that it will quash the litigious attitude surrounding these issues, i.e., we expect exceptions can always be found in any historical documents or that surplus distribution will continue to be used as leverage or a bargaining instrument. We

believe something more definitive needs to be in place and reiterate the point espoused in our submission to the Expert Commission which states,

“...We submit that, unless there are specific negotiated terms between sponsor and members defining the use of surplus, then the rights to surplus should be given in proportion to the parties’ responsibilities to fund deficits...”

- ◆ Recommendation 4-17
 - This recommendation will be difficult to apply in practice and needs to be reconsidered. There is an analogous rule which exists under the current PBA (Regulation 19(4) and 19(5)) which we understand has proven difficult for FSCO to enforce. Given that a previous recommendation gave the Superintendent the power to intercede and require an interim valuation (among other things), this Regulation 4-17 should be recast or removed.
- ◆ Recommendations 4-18
 - The principle of ongoing surplus withdrawals by plan sponsors subject to there being a minimum remaining cushion is sound. Member notification principles are proper. However, member consent to this seems too draconian particularly for non-contributory arrangements.
- ◆ Recommendations 4-19 and 4-20
 - General agreement
- ◆ Recommendation 4-21
 - We do not understand the logic of this recommendation. If anything, in terms of minimum standards legislation, the unproclaimed provision on indexation should be removed from the PBA.
- ◆ Recommendations 4-22 and 4-23
 - General agreement, but clarification is needed on whether this will change priorities on an insolvency vis-à-vis the degree to which pension plan obligations have precedent over unsecured creditors. Further, items such as Letters of Credit should be treated as assets in determining the level of funding required rather than

just a proxy for the funding.

- ◆ Recommendations 4-24 and 4-25
- General agreement

Chapter Five – Pension Plans in a Changing Economy

- ◆ Recommendations 5-1 and 5-2
 - General agreement. Note that in respect of Recommendation 5-2, the applicability should extend to all affected plan members regardless of province of employment.
- ◆ Recommendation 5-3
 - General agreement but this will require you to get changes made by the Canada Revenue Agency (CRA).
- ◆ Recommendations 5-4 through 5-6
 - General agreement
- ◆ Recommendation 5-7
 - General agreement with this principle; however, where there is an ongoing employer or plan sponsor, the requirement should not be mandatory, only permissive.
- ◆ Recommendation 5-8
 - The concept of “grow-in” rights has been problematic on a number of levels in wind-ups. This concept should be eliminated going forward, not expanded to the situation of normal member terminations as suggested.
- ◆ Recommendations 5-9 through 5-13
 - General agreement
- ◆ Recommendations 5-14 through 5-16
 - We feel such recommendations fail to properly address the concept of partial wind-ups and merely attempt to define some arbitrary limits by which an action should occur. We believe that, in this form, anti-avoidance could evolve which would simply validate “bad” legislation. Moreover, the proposed limits do not differentiate between small plans and large plans with the threshold being potentially reached in a small plan situation simply due to a temporary bout of high turnover. We suggest this “fence-sitting” compromise be dismissed and adoption of rules which categorically dismisses the partial wind-up concept be

adopted. One needs to look no further than legislation in Quebec to see how this can be achieved.

- ◆ Recommendation 5-17
 - General agreement
- ◆ Recommendations 5-18 and 5-19
 - These require further review. Notice principles are proper. However, we do not agree with the requirement of “positive” member agreement. If a member consent principle must occur, then the force behind the principle should be one where no more than X% (say 1/3) of members in a class, do not dissent. This has been the trend adopted by some other jurisdictions and we believe it to be pragmatic. The ability to secure positive consent at high percentages is an arduous task and implicitly presumes that such members indirectly control compensation policy of the sponsor.
- ◆ Recommendations 5-20 and 5-21
 - General agreement
- ◆ Recommendation 5-22
 - We are again concerned with the premise that the members can control the prospective actions of the sponsor.
- ◆ Recommendation 5-23
 - General agreement

Chapter Six – When Plans Fail

- ◆ Recommendations 6-1 through 6-4
 - General agreement provided that, if the “member approval” principle is to remain, it be recast into the “not more than X% dissent” style.
- ◆ Recommendation 6-5
 - The principle seems fine in theory but requires greater clarification. For example where would things like ad-hoc or contractual benefit indexation fit into the picture?
- ◆ Recommendation 6-6 through 6-8
 - General agreement
- ◆ Recommendation 6-9
 - This principle seems fine. However, (i) it is unclear what is magical about the 5-year threshold, and (ii) some further

thought should be given as to whether there could be any flaw with the priority of claims being the same for all member cohorts and categories. There is an argument that the grow-in rights principle will skew values in favour of one cohort to the detriment of other cohorts such as retired members.

- ◆ Recommendations 6-10 through 6-12 – General agreement
- ◆ Recommendation 6-13 – This recommendation is one which simply buys time for further review. To the extent that finality on the principle of continuation or disbanding the PBGF can be reached, then this recommendation can be supported.
- ◆ Recommendations 6-14 and 6-15 – General agreement though, again, we are unsure what is magical about 5-years as the threshold level.
- ◆ Recommendation 6-16 – General agreement but the government needs to be cognizant of the practicalities of implementing measure from other risk-generating factors.
- ◆ Recommendation 6-17 – Any change to the PBGF benefit level should be deferred until the research under Recommendation 6-13 has been completed.
- ◆ Recommendation 6-18 – This recommendation should be coordinated in tandem with the research under Recommendation 6-13.
- ◆ Recommendation 6-19 – General agreement if the PBGF is to continue; however some form of reinsurance or government backstopping would be necessary under extreme economic conditions such as we are experiencing today.

Chapter Seven – Regulation

- ◆ Recommendations 7-1 through 7-7 – General agreement
- ◆ Recommendation 7-8 – General agreement, but with the caveat related to previous comments on member

- ♦ Recommendations 7-9 through 7-18
 - ♦ Recommendation 7-19
 - ♦ Recommendations 7-20 through 7-26
 - ♦ Recommendation 7-27
 - ♦ Recommendations 7-28 through 7-31
- consent revisions.
 - General agreement
 - General agreement though it is not apparent why the number of commissioners is shown as four.
 - General agreement
 - General agreement, however it may be difficult to secure the quality of talent needed in light of suggested limitations related to concurrent employment. Recently retired professionals of appropriate repute could fill the gap but only temporarily as their practice inactivity would eventually compromise their ability to effectively adjudicate – quite the “Catch-22”.
 - General agreement

Chapter Eight – Governance

- ♦ Recommendations 8-1 through 8-8
 - ♦ Recommendations 8-9 and 8-10
 - ♦ Recommendations 8-11 through 8-14
 - ♦ Recommendations 8-15 through 8-21
 - ♦ Recommendations 8-22 and 8-23
- General agreement
 - We remain unconvinced that SEPP sponsors would willingly agree to essentially transfer operational power to groups of members. Furthermore, unless the member representatives were granted some form of qualified privilege, it is questionable how willing they would be to participate.
 - General agreement in principle, but the tasks may be arduous and time consuming.
 - General agreement
 - Compliance with such disclosure requests could end up producing some documents being written with broad, sweeping motherhood statements so as to render them dubious in value. Notwithstanding this concern, there is general agreement

- with the principles of reasonable disclosure.
- ◆ Recommendations 8-24 through 8-26
 - A mandatory requirement for pension advisory committees is not likely to be accepted by SEPP sponsors if it either adds to expense of running the plan or in some way transfers “leverage” power to these individuals. There is an underlying presumption that joint governance concepts will be embraced by SEPP sponsors. We have seen nothing that would convince us that this is the case. In any event there would certainly need to be an exemption of this requirement for small plans, i.e. those with, say, less than 1,000 members.
 - ◆ Recommendation 8-27
 - This may provide for a theoretical option for a SEPP sponsor. However, the take-up rate would be questionable, particularly when control or power to act will have been compromised.
 - ◆ Recommendations 8-28 through 8-30
 - General agreement

Chapter Nine – Innovation in Plan Design

We agree in general with everything proposed in this chapter as it allows the shackles on creativity to be removed. Target Benefit plans should not be restricted to collectively bargained situations.

Chapter Ten – The Future of Defined Benefit Pensions and Pension Policy in Ontario

All the recommendations put forth in this chapter are reasonable and consistent with principles of long-term governance and both the sustainability and promotion of pension plans, specifically Defined Benefit arrangements.

Some Closing Thoughts

The Report serves as an excellent base from which changes should take place.

As you have seen from our comments above, we believe that a number of items require modification or reconsideration. However, this should neither detract from the work that has been done nor curtail the current momentum for measured change which abounds in Ontario and other jurisdictions.

There is a school of thought which suggests that any future expansion for registered plans at the margin must come from the SEPP arena. It therefore stands to reason that any reconstituted PBA must appear "friendly" to this cause albeit with reasonable safeguards and minimum standards to support members' benefit security. Any revisions to the PBA which do not recognize this will not satisfy the desired outcome in the Report of system expansion.

We thank you for this opportunity to provide our comments. We would be pleased to discuss any and all elements therein in the hopes of the creation of a revised sustainable system with enough flexibility to see things out for the foreseeable future.

We look forward to receiving your comments.

On behalf of my colleagues, I remain,

Sincerely yours,



Robert Rosenblat, F.S.A., F.C.I.A.
Senior Vice President
(416) 542-5606