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ONTARIO

Response to the Report of the Expert Commission on Pensions

February 23, 2009 **VIA COURIER**

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, ON M7A 1Y7

Dear Minister Duncan:

Re: Ontario Expert Commission on Pensions

We are pleased to enclose the response of the Ontario Teachers' Pension Plan (Teachers') to "**A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules**", the report of the Expert Commission on Pensions (the Arthurs Report).

We applaud many of the recommendations in the Arthurs Report. "A Fine Balance" is not only a comprehensive report on the state of Ontario's pension system, but indeed represents a balanced approach to resolving many of the issues that it addresses. Commissioner Arthurs has provided the Ontario Government with a way to move forward with constructive reforms to a regulatory system that has not kept pace with a continually evolving pension environment. Harry Arthurs and his Expert Advisors are to be commended for their collective efforts in addressing so many difficult issues affecting the Ontario pension system in such a thorough and considered fashion.

Given the breadth of the Arthurs Report, we would encourage the Ontario Government to adopt immediately a strategy and a timetable within which to respond to the Report as a whole. Many of the recommendations are presented as part of a balanced package of reforms and should be considered together, rather than addressing only those pieces of a package that may seem more readily resolved. At the same time, we recognize that prioritizing the Report's many recommendations will be necessary in the short term, and the enclosed document provides some suggestions in this regard.

The enclosed document provides a comparative summary of the issues that were raised in our October 2007 submission to the Arthurs Commission, related recommendations from the Arthurs Report, and our response to those recommendations.

We intend to post this letter, as well as the enclosed document, on our web site for the benefit of our members and other stakeholders. As in the past, we remain available to provide whatever assistance may be necessary to help further this important pension reform initiative for the benefit of Ontarians.

Sincerely,

Jim Leech, President & CEO

Encl.

Teachers' Response to the Arthurs Report

Given Teachers' varied mandate as a large plan administrator as well as a significant investor and shareholder, we addressed three primary issues in our October 2007 submission to the Arthurs Commission: Funding, Investment Rules and Administration.

Here's what we said, what the Arthurs Report has recommended (recommendations are provided below in either summary form or detail, and with emphasis, as appropriate), and our response to those recommendations.

Funding

i. Fair sharing of surpluses and deficits

We said that surpluses should be fairly allocated among the parties who assume responsibility for the funding risks associated with a defined benefit pension plan. We suggested that the current system effectively encourages employers to <u>under</u>fund their plans (because they're responsible for deficits, but they can't necessarily utilize surpluses) and that institutional investors (such as Teachers') shy away from investing in companies with 'unknown liabilities' such as DB plans.

> Recommendations 4-13 to 4-15 — **Single-employer pension plans** (**SEPPs**) should be funded on the basis of both solvency and going concern valuations (as at present) but **should maintain a security margin of 5% above full funding**. **Once plans are funded at 95% [solvency] or higher, they should be allowed a longer amortization period** to meet their funding obligations.

> Recommendation 4-17 — **Sponsors should be allowed to** reduce or suspend contributions (**take a "contribution holiday"**) **if the plan is funded at 105% or more**, but must resume contributions immediately if funding falls below 95%. Sponsors who take or continue an unauthorized contribution holiday may be ordered to repay all amounts improperly withheld, as well as an administrative fine of up to $1 million.

> Recommendation 4-18 — **Sponsors should be allowed to withdraw surplus from an ongoing plan if it is funded at more than 125%**, subject to similar procedures.

> Recommendation 4-16 — **Surplus remaining in a SEPP when it is wound up should be distributed in accordance with the plan documents, if they are clear. If not, the surplus should be distributed as proposed by the sponsor and agreed to by unions or** other representative organizations (or, in their absence, by **plan members** themselves). **Disagreements should be submitted for resolution** by a method agreed to by the parties, or if they cannot agree, by the proposed Pension Tribunal of Ontario.

Recommendation 5-12 — **Active plan members who are involuntarily terminated**, whether in groups or individually, while a plan is ongoing, **should not be entitled to an immediate distribution of surplus**. However, **those who leave their pension assets in the plan should retain the right to participate** in any subsequent surplus distribution.

Recommendation 5-21 — Following **conversion from a defined benefit to a defined contribution plan**, or to a hybrid plan with elements of both, **surplus** carried over from the original plan **should first be used to provide the required security margin** for defined benefits earned under either plan. If **additional surplus** remains, it **should be available to fund contribution holidays or other expenses of the converted plan**.

Recommendations 5-17 to 5-20 — **Splits and mergers** should generally not result in a reduction of funding levels below 105%. However, **surpluses over that amount should be available** to be used for plan purposes.

Our Response:

Teachers' is concerned that some proposed funding measures for private sector pension plans will not do enough to encourage the additional funding that is really necessary from plan sponsors to enhance the security of benefits promised to plan members.

We acknowledge that a 5% security margin, coupled with longer amortizations periods for plans funded above a 95% solvency threshold, may provide a reasonable balance between the often competing objectives of benefit security and affordability. We also acknowledge that more clarity around contribution holidays and surplus withdrawals (both ongoing and on wind up) is desirable, as is clarity regarding the use of surplus on plan conversions, splits and mergers.

However, we are concerned that the "substantial stick of enhanced funding requirements and tighter controls on contribution holidays"[1] (and plan expenses) will far outweigh the 'carrot' of "properly controlled surplus withdrawal"[2] for private sector plan sponsors. We note that the Alberta/B.C. Joint Expert Panel on Pension Standards (JEPPS) has recommended a "pension security fund" as a means of providing plan sponsors with appropriate access to excess funding that is not ultimately necessary for promised benefits. The JEPPS has also recommended "ring-fencing" to allow plan sponsors to administer their plans on a prospective basis without the uncertainty of legacy issues regarding surplus. Both of these proposals would seem to represent a reasonable approach that is worth considering for plan sponsors here in Ontario.

We also believe, consistent with the JEPPS recommendations, that legitimate plan expenses [and legislated PBGF premiums] should be payable from a pension plan without restriction, unless plan documents explicitly provide otherwise.

[1] Report of the Expert Commission on Pensions p. 80
[2] ibid

ii. Income Tax Act barriers to building a surplus

We said that the 110% funding limit in the ITA precludes enhanced plan funding when the investment climate is conducive to growth.

> **Recommendation 4-24** — The **Ontario government should** endeavour to **persuade the federal government to increase benefit and contribution levels for registered pension plans** under the *Income Tax Act*, and to consider policies that encourage participation by workers and employers in DB plans or their functional equivalents.

Our Response:

Recommendations that encourage certain tax changes at the federal level (dealing with contribution and benefit limits) are helpful, and we urge the Ontario Government to pursue such changes forthwith, with requests for the support of other jurisdictions if necessary. We also endorse recommendations in the Report towards greater uniformity of pension regulation across Canada, as well as efforts to secure desirable changes to federal tax and insolvency laws.

iii. A pension plan's dependence on a third party actuary

We said that the role and accountability of the plan actuary needs to be clarified to resolve potential conflicts between the actuary's need to report on the long term sustainability of the plan (given existing benefit levels and contribution rates) versus the short term funding concerns of the employer (who hired the actuary). Actuarial advice would be improved if multi-year projections were completed. We suggested that written funding policies, if required of plan sponsors, could provide better guidance and transparency around funding issues, assumptions and the preparation of valuations.

We also said that actuarial standards of practice need to evolve quicker, and ought to specify how economic assumptions within a funding valuation should be developed.

> **Recommendation 4-1** — The Superintendent should work with the Canadian Institute of Actuaries to **ensure that actuarial standards** and practices continue to **evolve in the direction of greater transparency and more structured discretion**. For example, **actuarial valuations should reveal the reasons behind the assumptions used in valuations to set discount rates and to select the mortality trends used to calculate plan liabilities**. They should also reveal whether the sponsor intends to take a contribution holiday.

> **Recommendation 4-2** — The Superintendent should have the power to require that plans cease using assumptions that are unreasonable or that depart materially from accepted actuarial practice, and to order an independent valuation or peer review of a report, at the expense of the plan, if there are grounds to believe that the actuarial valuation misrepresents a material factor in its funding.

> **Recommendation 4-3** — **Going concern valuations should no longer permit the exclusion of promised indexation benefits. Solvency valuations should no longer permit the use of smoothing** practices **or the exclusion of benefits**. A special exception should be made for those plans that continue to provide plant closure benefits pursuant to a specific, long-standing commitment to continue their non-funded status. Potential increases in sponsor contributions attributable to these enhanced transparency measures should be offset so far as possible by the extension of amortization periods, by selective relief from contribution increases for well-funded plans or by other means.

> **Recommendation 4-4** — The current requirement for an actuarial valuation every three years should be maintained. The **time for filing the valuation after it is due should be reduced from nine to six months**. Extensions should be given only in exceptional circumstances.

> **Recommendation 4-5** — Plans whose triennial valuation shows that their funding has fallen below a threshold to be specified by regulation should continue to be required to perform and file an annual valuation.

> **Recommendations 8-9 to 8-15** — Plans, with the assistance of the proposed Pension Champion, should take steps to **clarify, extend and enhance the rules governing conflicts of interest and compliance with other fiduciary duties** by persons and organizations engaged in plan governance and administration. **Special attention** should be paid **to the role of professionals** who provide service or advice to pension plans.

Our Response:

The Arthurs Report recommends a number of changes designed to enhance pension plan governance, and the standards that apply to those involved (including professional advisors) in plan administration and pension fund investment. These are welcome suggestions for an industry where best practices are continually evolving, and where actuarial and other professional standards could be clarified.

iv. One size cannot fit all: the vastly different risk factors of public and private sector pension plans

We said that solvency rules are inappropriate for public sector plans and should only apply to private sector plans (where plan sponsor bankruptcy represents the greatest risk factor for the long-term viability of the pension plan). We also said that employers should not be permitted to avoid funding obligations on wind up and that, in the event of bankruptcy, benefit reductions should first be applied to recent benefit enhancements.

> **Recommendation 4-8** — MEPPs, JSPPs and SEPPs should have separate funding rules related to their distinctive characteristics. In general, MEPPs and JSPPs should be allowed more flexibility in funding, while SEPPs should be subject to stricter rules than other plans.

> Recommendation 4-11 — **Jointly sponsored pension plans should be required to fund only according to going concern valuations** on the same basis as Specified Ontario Multi-employer Pension Plans, **but should continue to provide solvency valuations for the information of the regulator as well as their active and retired members**. The comprehensive legislation and regulations governing the funding of multi-employer pension plans, to be developed pursuant to Recommendation 4-9, should apply, perhaps with appropriate modifications, to jointly sponsored pension plans.

> Recommendation 6-5 — **When a plan fails** and is being wound up, payments attributable to **benefit improvements initiated up to five years prior** to the date of the wind-up **should be paid only after all pre-existing benefits are paid** in full.

Our Response:

Teachers' is particularly pleased with recommendations in the Arthurs Report recognizing the merit in different funding rules for defined benefit plans depending upon the governance, funding arrangements and risk characteristics of such plans. Such proposals should be acted upon forthwith. Solvency rules should continue to be the focus of regulatory scrutiny for pension plans where the potential risk of plan sponsor insolvency represents a significant risk for plan beneficiaries.

v. Shifting risks to those who are least equipped to manage them

We expressed the concern that the continued trend from DB to DC plans in the private sector is simply shifting more risks (longevity, investment, financing) to employees and, ultimately, to governments (i.e. taxpayers).

> Recommendation 5-22 — If a DB plan is converted to a DC plan . . . unions or other representative organizations (or, in their absence, the members themselves) should have an opportunity to approve the new arrangements. If they do approve, normal regulatory procedures should be expedited.

> Recommendations 9-2 and 9-3 — The best hope for maintaining, and ultimately expanding, pension coverage is to **facilitate the development of large plans**, to encourage cooperation among small- and medium-sized plans, and to promote target benefit plans that might be affordable for Ontarians who do not now have pension coverage.

> Recommendations 9-4 and 9-5 — In addition, the government should **investigate** the **advantages and disadvantages of expanding the Canada Pension Plan**, **or creating a** comparable **provincial plan**, so as to enhance pension coverage, control costs and improve benefit portability. It should also support the call for a national pension summit to investigate all ideas that might produce such outcomes, including those contained in this report.

Our Response:

Although pension coverage is not an issue that was specifically addressed in Teachers' written submission to the Arthurs Commission, it is an issue that requires a more serious effort from governments right across Canada. The continued trend in this country from defined benefit to defined contribution arrangements is concerning, to the extent that it shifts many risks to the individual plan member, many of whom may outlive their savings.

What is even more troubling, however, is the lack of occupational pension plan coverage among Canadians generally, a situation that, left uncorrected, will continue to burden future generations. Therefore, we welcome recommendations 9-2 to 9-5 in the Report that encourage steps towards increased coverage, and we urge the Ontario Government to investigate and/or pursue such measures.

Investment Rules

i. Unnecessarily restrictive investment rules

We called for elimination of the existing quantitative and qualitative restrictions (in particular the 30% rule) which simply limit, and inflate the cost of, appropriate investment opportunities.

> **Recommendation 4-25** — The **Ontario government should** endeavour to **persuade the federal government to reform the federal investment rules** and, in particular, to remove or amend particular quantitative restrictions that no longer make sense, such as those involving prohibitions on Canadian, but not foreign, investments. However, **if the federal government does not do so within a reasonable time frame, the Ontario government should** cease to rely on the federal regulations and **establish its own investment rules**, tracking the federal rules only to the extent that doing so is deemed good public policy in Ontario.
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> **Recommendation 8-8** — **Any plan with** some recognized form of **joint governance and** with the requisite **capacity to make complex investment decisions** (as defined by regulations) **should be allowed to** adopt a resolution **claim**ing **an exemption from the 30% investment rule**. The resolution should be filed with the pension regulator and have effect upon filing, unless and until it is successfully challenged.
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> **Recommendation 8-23** — Plan **statements of investment policy should reveal whether, and if so, how, socially responsible investment practices are reflected** in the plan's approach to investment decisions.

Our Response:

Recommendations in the Arthurs Report dealing with possible changes at the federal level concerning investment restrictions are welcome, but not terribly helpful, since Ontario already has the jurisdiction to move forward with its own pension investment rules (as has been recommended in Alberta and B.C. in the recent JEPPS Report, as well as in the Report of the Nova Scotia Pension Review Panel). It is Teachers' view that the Ontario Government should simply pursue, forthwith, reforming its own investment standards for pension plans registered in the Province to remove the current quantitative restrictions.

At the same time, we are pleased to see the Report's recommendations that would allow jointly governed plans with sufficient investment expertise to claim exemption from the existing 30% rule. This will allow such plans to compete for appropriate investments globally, on a more equal footing with other investors (both domestic and foreign).

Administration

i. Cumbersome administration

We pointed to the inadequate framework dealing with pension division on marriage breakdown, and inflexible rules affecting the portability of pensions, as two examples of plan administration that could be simplified and clarified for the benefit of plan administrators, plan sponsors (in whom Teachers' invests) and plan members. We also mentioned the shortened life expectancy (SLE) rules as another example of complexity, cost and inefficiency affecting plan sponsors.

> **Recommendation 5-4** — **Transfers of members among plans should be facilitated by requiring** employers to develop a standard policy dealing with the pension rights of newly hired employees, and by providing full information and **a range of options to employees seeking to transfer their former pension rights to their new plan**.
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> **Recommendation 5-5** — The government should promptly address the situation of **public service employees affected by the restructuring** of government responsibilities and agencies **in the late 1990s**.

With respect to pension division on marriage breakdown, we note that the Attorney General has introduced Bill 133 which would allow plan members who separate before retirement to divide immediately their pension entitlement with their spouse, a method for which we have long advocated.

Our Response:

We applaud efforts to enhance the portability of pensions, but would caution against any measures that become overly complex. We would support efforts to enhance portability between jurisdictions, not just between pension plans within Ontario. We would also support efforts to enhance disclosure to plan beneficiaries but would observe that active members and retirees typically have differing informational needs.

We are concerned about the potential cost implications of proposals regarding immediate vesting of pension benefits. Teachers', like many public sector pension plans, continues to search for thousands of former members who are entitled to refunds for small periods of historical service that were not vested (under legislated vesting rules) when they ceased active plan membership. (The proposal to establish an Ontario Pension Agency to manage pension funds for former plan members that cannot be located would greatly assist with this challenge.) Therefore, immediate vesting, in our view, should only apply to the accrual of active service on a prospective basis.

There are many technical and operational issues within the Expert Advisors' Consensus Recommendations (appended to the Arthurs Report) that would assist in clarifying a number of Pension Benefits Act (PBA) provisions. We support legislative clarification generally, and we fully support measures (such as death registry access, disclosure by electronic means, and confirmation of member data) that could reduce administrative burdens associated with regulatory compliance.

ii. Lack of consultation before changes are adopted

We mentioned the SLE rules and, in particular, the Jointly Sponsored Pension Plan (JSPP) funding rules (to which Teachers' is subject) as two examples of inadequate consultation by Ontario Finance prior to enactment.

> **Recommendations 10-1, 10-2, 10-5 and 10-6** — The government should enhance its capacity to collect and analyse pension data; to use this data and analysis to support ongoing and periodic reviews of pension policy and the performance of the pension system; and to share it with stakeholder, professional and academic users. **A new Pension Community Advisory Council should be formed representing all these groups, and it should be invited to advise government on all significant policy initiatives and to serve as a forum for the exchange of views**. This new approach to pension policy making should be **led by the Pension Champion**, which should be given adequate staff and resources.
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> **Recommendations 9-1 and 10-5** — Innovation requires active promotion and facilitation by a **Pension Champion — a new government agency that would assume responsibility for collecting and disseminating reliable information** about the pension system, **for thinking creatively about new pension strategies and policies**, and **for working with stakeholders to improve the pension system**. It also requires an adaptable legislative and regulatory framework.

Our Response:

Changes to the overall regulatory structure, including enhanced resources, are long overdue. A more efficient, more responsive and better resourced regulator and tribunal would be beneficial to the pension system in Ontario and to all stakeholders (including Ontario taxpayers).

At the same time, the establishment of an industry advisory council and a 'Pension Champion' for Ontario would provide a more effective voice for an industry that is constantly changing, so that pension reform becomes a dynamic process and not simply a static event every 20 years.