February 27, 2009

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:

Attached you will find comments from the Canadian Institute of Actuaries on the recommendations in the Report of the Expert Commission on Pensions.

There were numerous important issues explored in the report, and many interesting recommendations made. Having the public interest in mind, the Institute supports many of them. However, there are some fundamental topics where the Institute disagrees with either the recommendation or the underlying rationale, and we appreciate the opportunity to bring these to your attention. As well, we would be pleased to discuss them with you personally at your convenience.

Yours truly,

Michael A. Hale, MBA, FCIA
President

Submission by the Canadian Institute of Actuaries to The Honourable Dwight Duncan, Minister of Finance – Ontario

February 2009

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Ce document est disponible en français

Preface

The Canadian Institute of Actuaries (CIA) establishes the Rules of Professional Conduct, guiding principles and monitoring processes for actuaries, all of which adhere to the profession's Standards of Practice. The CIA takes the role of serving the public interest seriously and in carrying on its activities and programs, the Institute holds the duty of the profession to the public above the needs of the profession and its members.

The CIA also assists the Actuarial Standards Board in developing Standards of Practice applicable to actuaries practising in Canada, including those governing actuarial valuation of pension plans.

Almost half of the Institute's 3,800 members practise in Ontario, and just under 40% of them work in the pension field.

Actuaries have considerable experience and rigorous training in the pension field and a commitment to serve Ontarians' interests. The Institute values the opportunity to participate in efforts like this to advocate for positive change in the pension system.

General Comments

While we agree that a decrease in the percentage of Ontario's workforce represented by unions and the loss of jobs in the manufacturing sector are factors in the steady decline in pension coverage over the past 20 years, we believe that there are many other contributing causes to this situation. The uncertainty about surplus ownership is very important as is the country's patchwork of regulations, legal decisions, tax rules and changes in accounting standards. Layered on these are the further problems of years of low interest rates, increasing longevity, volatile market yields, rising pension costs, and uncertainty regarding contribution holidays.

That is a snapshot of today. However, **Ontarians want and deserve a pension system built for the environment of tomorrow, one for the modern economy.** Not every citizen is a union member or a public servant. Yet, if the current trend continues, eventually they may be the only members of a defined benefit pension plan. This will not sit well with future tax payers and voters. The time for government action is now.

Governments should do their best to encourage defined benefit pension plans and should not unduly interfere with their successful operation. Defined benefit pension plans are an essential component of Canada's pension system. By a large margin, defined benefit pension plans generate better financial results. They protect members from such things as longevity risk. Moreover, larger defined benefit pension plans typically achieve better results than smaller plans. Does it not make sense for governments to improve the environment in which these plans could flourish?

The concept of a Pension Champion is an interesting one. In order to improve the pension system, such an agency must have stability. It should be protected from the whims of government budgetary pressures.

We believe that facilitating the creation of new plans, the development of large plans and fostering cooperation among small- and medium-sized plans are excellent ideas. Increasing the number of available plan design options would increase pension coverage. The implementation of a framework encouraging the creation of large plans (especially for defined contribution plans) would increase access to a wider array of investment options, potentially decrease costs, and enable pooling of certain risks.

We encourage the government to explore some of the more creative options presented in the report. Creating a voluntary defined contribution provincial plan is one. Expanding the Canada Pension Plan is another. While the financing costs for the latter option would lead to higher taxes on the Canadian workforce, it may be an appropriate way to rebalance the three legs of the retirement income stool - i.e., government programs, private employer plans, and personal savings. As we have said elsewhere, the population is not saving enough for their independent retirement. These options may help, and should be looked into. However, an expansion of the Canada Pension Plan would involve a long consultation process with other governments. We suggest prioritizing improvements to the private pension plan framework. These could be rapidly implemented and produce quick tangible results in terms of pension coverage.

We support the recommendation that pension legislation should be reviewed every eight years.

We support the idea that there should be more convergence in pension legislation and regulation across the country. Considering the pension review currently in-process federally and the work already completed in Ontario, British Columbia, Alberta and Nova Scotia, there would be no better time than now to hold a National Pension Reform Summit where ministers responsible for pensions could gather together to discuss a variety of common issues, for example, the decline in pension coverage, harmonization of legislation and regulation and challenges faced by defined benefit and defined contribution pension plans. The Canadian Institute of Actuaries is ready to help organize and participate in such a meeting.

Pension Plan Funding

Transparency of Actuarial Valuations (4-1 to 4-3). Pension actuaries strive for clear, accurate and user-friendly valuations. If there are ways of improving them, we are confident that the Actuarial Standards Board (ASB – the independent body responsible for monitoring and developing actuarial Standards of Practice) would be pleased to hear about them. In fact, the Standards have recently undergone some very important changes that impact pensions.

Valuation Filings (4-4 to 4-7). We agree with the recommendation that plans whose valuations fall below the fully funded level should require annual valuations. Plans that meet that funding level plus a risk-based Target Solvency Margin should be allowed to take contribution holidays and the Institute believes the rules around this as well as the regulator's power to order an interim valuation must be clearly prescribed in the regulations.

Funding rules need to be different depending upon how the risks are shared (4-8 to 4-12). For that reason, we support the recommendation that different funding rules be imposed on different types of plans, such as Single-Employer versus Multi-Employer Pension Plans (MEPP). Furthermore, we believe that there should be some flexibility in the funding rules to accommodate new and innovative risk-sharing arrangements. For example, different types of Single-Employer Pension Plans (SEPP) should, themselves, be subject to different funding rules depending on the way the risks are shared between members and the plan sponsor.

Target Solvency Margin (4-13 and 4-15). We support this concept. However the Target Solvency Margin (TSM) should be a variable amount, linked to the risk inherent in each plan and mismatch between the assets and liabilities in the plan. Furthermore, plan sponsors are unlikely to accept the TSM concept unless the uncertainty about surplus ownership is addressed.

The Institute worked closely with the Québec pension authorities to prepare a research paper on the Determination of Appropriate Provisions for Adverse Deviations (PfADs) for hypothetical wind-up and solvency valuations of defined benefit pension plans. The implementation and ongoing monitoring of the TSM should not involve high complexity, cost or work. The development of such a margin should balance the need to accurately reflect the plan's risk exposure with the need for simplicity, recognizing the small size of some plans. The Institute believes the proposed across-the-board 5% TSM is arbitrary, and a more scientific approach is warranted.

As stated in our submission to the Expert Commission on Pensions in 2007, the TSM could work in tandem with a Pension Security Trust (i.e., a new type of funding vehicle with clear ownership of assets to supplement the existing pension plan trust fund) and letters of credit. Plan sponsors could pay the additional contributions required to meet solvency funding requirements into the Pension Security Trust or use a letter of credit for this purpose. Use of the Pension Security Trust and/or a letter of credit instead of the regular fund would ensure that any part of TSM not ultimately needed to provide plan benefits would be accessible by the plan sponsor. We note that the Alberta – B.C. Joint Expert Panel on Pension Standards has recommended that solvency contributions be remitted to a Pension Security Fund which is similar to the Pension Security Trust described above. We strongly recommend that the Ontario government consider implementing this approach.

Access to Surplus. (4-16 and 4-18). We believe that some changes are required in this area. While the recommendations are not perfect, they certainly are better than the rules now in place, as they would allow surplus to be handled according to clear provisions in plan documents.

However, the proposal does not give sponsors complete certainty at the time that they might be considering putting money into the pension plan, because some stakeholders may not agree that the plan documents are completely clear, and historical documents may be used to challenge the wording of current documentation. Such uncertainty may lead sponsors to be reticent in increasing the funding of their plans and thus may actually reduce security in these plans.

We recognize that existing contracts or agreements between the plan sponsor and plan members will need to be respected. Therefore, we support the "Fresh Start" concept advanced by the Alberta – B.C. Joint Expert Panel on Pension Standards as it allows plan sponsors to "ring fence" existing plans and establish new pension plans for future service that have clear surplus entitlement language.

As mentioned previously, in order to address the surplus ownership and utilization issues, we recommend permitting the use of a Pension Security Trust to receive solvency contributions. This fund would be complementary to, but separate from, the regular pension plan fund and would be used to increase funding levels and enhance benefit security for plan members.

Indexation of Benefits (4-21). Obviously there are costs involved in indexing pension benefits. It would be inappropriate to require the indexation of accrued pension benefits as this would retroactively change the "pension deal". If post-retirement indexation is required for future pension accruals, the rules governing such indexation must be very clear and must allow the parties to evaluate the indexation costs. We note that no jurisdictions in Canada currently require indexation to be provided on pensions in payment.

Ontario Pension Agency (5-2 and 5-6). We support the proposal of a government agency that helps plan sponsors dispense pension funds left stranded when members lose contact with the plan administrator.

Transfers of Members among Plans (5-3, 5-4 and 5-6). We support the idea that newly hired employees be made aware of their options, however, the proposed default option would create major administrative problems on many levels; is impractical if the two plans provide vastly different types of benefits; generates several public policy issues; and will interfere in normal business transactions. We would prefer that transfers of members among plans continue to be handled on a case-by-case basis depending on the circumstances.

Grow-in Rights (5-8 and 5-9). We believe that existing and these proposed grow-in rights generate arbitrary inequities among members. The recommendations substitute one set of arbitrary distinctions with another worse set. For example, the report proposes that involuntarily terminated workers in SEPPs should have rights, while those in MEPPs, Jointly Sponsored Pension Plans (JSPPs) or other jointly governed plans should not. Moreover, members who voluntarily terminate just before a reorganization or closure would not have rights, whereas those who remain would. We note that the distinction between voluntary and involuntary termination is not always clear. The introduction of rules based on this distinction would entail a significant potential for legal litigation expenses, which would not be in the best interest of the whole plan.

Ontario and Nova Scotia are the only jurisdictions in Canada that require grow-in benefits to be provided on plan wind-up, and Ontario is the only jurisdiction that requires recognition of these grow-in rights for solvency funding purposes. We note that the recently released final report of the Nova Scotia Pension Review Panel recommends that pension plans no longer be required to provide grow-in rights. Maintaining these benefits would further increase inconsistency of pension legislation between Ontario and other jurisdictions.

If, for public policy reasons, the Ontario government decides that grow-in rights need to remain, the *Pension Benefits Act* and its regulations should clearly state the criteria to determine when these rights must be granted. We recommend that these criteria not be based on the circumstances of the member's termination. Moreover, as mentioned above with respect to indexation of benefits, it would be inappropriate to implement new grow-in rights that would increase the cost of already accrued pension benefits.

Phased Retirement (5-10). We agree with this recommendation.

Immediate Vesting (5-11). We agree with this recommendation, but note that when immediate vesting was introduced in Québec, it was coupled with the elimination of the partial wind-up concept. That combination was considered to be a fair compromise.

Partial Wind-Ups (5-14 to 5-16). We prefer to see that partial wind-ups are eliminated completely; however, if the government does continue them, we appreciate that these recommendations would bring more clarity. That said, we find several terms such as "bona fide" and "reconfigured" in 5-15 to be rather vague. Absent of more clear language, there should be opportunities to challenge or appeal decisions made by the Superintendent.

Union or Member Organization Approval of Plan Splits or Mergers (5-17 to 5-20). We believe that 5-19 makes things more complicated than necessary and there are a number of practical difficulties in implementing the proposal. The only restrictions or conditions on plan restructuring transactions should relate to preserving security of accrued benefits and ensuring reasonable equity between transferring and continuing plan members. We recommend that plan restructuring rules be prescribed in the *Pension Benefits Act* and Regulation to facilitate these transactions recognizing that benefit security of affected employees will remain a key consideration.

Conditions for Plan Splits, Mergers, Asset Transfers or Conversions (5-21 to 5-23). We agree with these recommendations.

When Plans Fail

Defining Plan Failure (6-1 to 6-4). There is an issue about defining a plan failure and the risk of uncertainty for plan sponsors. Often the plan may not be the problem, but the sponsor may be at risk. The sponsor may have already made its contribution to the plan, and suddenly be faced with a demand for additional funds at the worst possible moment. While the proposal may be an enabling idea for the Superintendent some of the powers are more like those of the court.

When a Plan Fails (6-9 and 6-15). The proposal is to use a pro rata approach to adjusting benefits, once benefit improvements approved within the last five years are excluded. There may be circumstances where the pro rata approach is not fair and equitable to all plan members. The Superintendent should have discretion to approve other methods for allocating assets in an equitable manner that are not pro rata.

Unpaid Current Service Costs and Special Payments in Bankruptcy (6-10 to 6-12). We agree with the spirit of the proposal, however, there needs to be more clarity in the language. For example, does it mean the special payments due up to the bankruptcy date, or special payments that were scheduled to recover the full deficiency as measured at the last valuation date?

Pension Benefits Guarantee Fund (PBGF) (6-13 to 6-18). We believe that the fund should be designed with more insurance principles than the current version. We believe that if the CIA's proposals in the Pension Prescription were implemented, pension plans in Ontario would be more likely to be well funded, and the need for a guarantee fund would be reduced. The report proposes a study on whether to keep the fund or not. We support the idea of a study, but recommend that while this work is being done, no changes should be undertaken until the future role of the guarantee fund has been made clear.

We agree with recommendation 6-15, which extends the period of benefit improvements excluded from PBGF coverage from the current three years to five years prior to plan failure.

Regulation and Governance

PBA Becomes the Exclusive Source of Law on Pensions (7-1 to 7-3 and 7-17). We support these recommendations as they will improve clarity and remove uncertainty.

Role of Professional Standards (7-4). We support the recommendation for the regulator to work closely with professional governing bodies in developing professional standards affecting the pension system. Such cooperation is already taking place in the case of the actuarial profession, and recent changes to the Institute's procedures have further enhanced transparency and accountability in setting standards.

In the public interest, several years ago the Institute handed over responsibility for maintaining and developing actuarial Standards of Practice to an independent body, the Actuarial Standards Board (ASB). The work of the ASB is overseen by yet another independent body, the Actuarial Standards Oversight Council. The work of the ASB is very transparent, with meetings and consultations both inside and outside the profession with stakeholders. Regulators are very well aware of the direction of the ASB, the Standards that are in play and deadlines for the adoption and implementation of Standards. Additionally, there are often actuaries from various regulators serving on CIA practice committees, who, on an informal basis, connect the profession with the regulatory community. Finally, the Institute meets regularly with the Canadian Association of

Pension Supervisory Authorities (CAPSA), Office of the Superintendent of Financial Institutions (OSFI), Financial Services Commission of Ontario (FSCO) and other organizations to share information.

Powers of Superintendent (7-15). We agree with the proposal.

Regulator's Efficiency (7-5 to 7-6, 7-7 to 7-8, 7-11, 7-12 to 7-14 and 7-16). We agree with these sensible recommendations.

Establishing and Publishing Performance Benchmarks (8-1). We question the value of this recommendation as it has the potential to become an expensive exercise for the regulator and for plan sponsors, which may yield results of little practical value to either group.

Proposals to Improve Plan Governance (8-2 to 8-23). We support ideas that would improve plan governance, however, any resulting changes must a) be practical; b) not add an undue administrative burden and c) be cost-effective.