

March 10, 2009

Hon. Dwight Duncan  
Minister of Finance  
Frost Building South  
6th Floor  
7 Queen's Park  
Toronto ON M7A1Y7

Dear Minister,

**RE: OPB comments to Minister of Finance in response to OECR Report**

Ontario Pension Board (“OPB”) is grateful to have the opportunity to provide comments to the Minister of Finance on the Ontario Expert Commission on Pensions (the “Commission”) Report: “A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules” (the “Report”).

**WHO WE ARE**

OPB is a statutory corporation responsible for the administration of the Public Service Pension Plan (the “Plan” or the “PSPP”), and for the prudent investment of the assets that fund the benefits provided under the Plan. The PSPP is a statutory defined benefit (DB) pension plan sponsored by the Government of Ontario (the “Plan Sponsor”) and established under the *Public Service Pension Act* (“PSPA”). The Plan has assets of approximately \$14 billion. Its membership is made up of eligible employees of the Ontario government and its Agencies, Boards, Commissions and Public Bodies. There are approximately 78,000 members and pensioners in the Plan. The PSPP is one of Canada’s oldest pension plans, dating back to the 1920s and has been delivering the pension promise to its members successfully for almost 100 years.

While the PSPP is a “sole sponsored”<sup>1</sup> plan, the Board of Directors of OPB includes members who are nominees of Bargaining Agents who represent members of the Plan. In other words, although the PSPP isn’t a multi-employer plan or jointly sponsored pension plan, it provides for stakeholder participation in plan governance (i.e., the PSPP has member involvement embedded in its governance structure.)

The foregoing is critical context to bear in mind while considering our response to the Report.

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<sup>1</sup> By “sole sponsored” we mean that a plan is administered as a single employer sponsored plan and is not a jointly sponsored pension plan or a multi-employer pension plan.

## **OPB'S COMMENTS ON THE REPORT**

OPB commends the Government of Ontario for recognizing the need for pension reform in Ontario and establishing, and setting a progressive mandate for, the Commission. Several other jurisdictions in Canada have followed Ontario's lead, including British Columbia, Alberta, Nova Scotia and, recently, the federal government.

We would like to express our appreciation for the Commission's efforts over the past year and commend Commissioner Harry Arthurs and his colleagues for producing a thoughtful Report that addresses a wide range of issues impacting the pension system in Ontario.

We have reviewed the Report in detail and are very supportive of the majority of its recommendations. There are a small number of recommendations which we strongly believe need to be further developed or modified if they are to be implemented. Our response focuses on those areas of the Report rather than outlining our areas of agreement.

### **Pension Portability**

We strongly support the Commission's recommendation to make the legislative amendments necessary to enable pension portability in divestment transfers. Our recommendation is that the Commission's recommendations be implemented quickly and that the legislative changes enable pension plans to negotiate transfer agreements that permit individuals subject to past divestments to consolidate their credit and assets in one pension plan. The Commission's recommendation is consistent with the recommendation we made in our submission. We note that, since we filed our submission with the Commission, OPB has completed the implementation of a pension transfer agreement for police personnel divested into or out of the Ontario Provincial Police. This transfer agreement did enable individuals subject to past divestments to consolidate their pension credit and assets. The implementation went very smoothly. We can now say that the individual choice pension transfer agreement model developed by OPB and OMERS works and that model should be the framework for implementing a solution to this long-standing issue.

### **Implications of the Current Economic Environment**

We also note that the current economic environment is dramatically changed since the Commission considered its recommendations and submitted its Report. Our view is that the priorities for longer term pension reform should remain very high on the Government's agenda. In addition, we believe that the priority in the short term ought to be focused on funding relief (both going concern and solvency) and recommend that the Government consult with the pension industry as to the appropriate funding relief measures in light of the unprecedented economic and capital markets environment in which we currently operate. We would embrace an opportunity to participate in those discussions.

## **SUGGESTIONS FOR MODIFICATION OF THE COMMISSION'S RECOMMENDATIONS**

### **OPB Recommends Risk-Based as opposed to Form-Based Funding Regulation**

The legislative regime OPB recommends (also contained in our initial submission to the Commission) is one that would create a framework or foundation that enables various forms of pension arrangements and then applies a risk-based consumer protection approach to regulating each plan. For this purpose, we define risk as the possibility of loss of accrued benefits to a member or pensioner. Such an approach would be neutral as to form and would focus instead on the substance of the funding adequacy risk of the particular plan. The lesson learned since the last reform of pension regulation in Ontario is that we cannot anticipate the changes over time that result in moves toward or away from one form of pension arrangement. The regulatory environment for pension plans needs to be flexible so that it can adapt to changing realities.

Our read of the Report is that the Commission is recommending a regulatory regime that would retain the existing going concern and solvency funding measures as the primary regulatory oversight mechanisms. We think those measures need to be reconsidered. In the approach we recommend, we are not referring narrowly to funding requirements but to the development of a series of measures and indicators to enable a regulator to screen the risk levels in a plan and focus its regulatory oversight on those with the highest levels of risk. The regulator would be empowered to mandate measures be taken to mitigate that risk, including demanding that the plan administrator provide its plan to do so. This is the approach now successfully applied by OSFI to federally regulated insurers. It would require a strongly resourced regulator to build and implement policies and guidelines to proactively monitor and address the actual risk level of plans to protect the ultimate delivery of the accrued pension promise in an ongoing plan. In such a regime continuing with the existing solvency funding requirements, for example, might not be necessary or appropriate.

In addition, our read of the Report is that the Commission is recommending a regulatory regime that would apply different funding requirements based on the model or form of the plan and in doing so favour jointly sponsored plans and target benefits plans over sole sponsored plans. The primary<sup>2</sup> way the Report does this is by recommending that more stringent funding rules apply to sole sponsored plans than jointly sponsored plans. One example of this is the recommendation that sole sponsored plans be required to include indexing of liabilities in their regulatory solvency funding valuations but that jointly sponsored plans not be required to do so. We do not see a sound basis for this differential approach for arrangements where the expectation of the members is

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<sup>2</sup> Another example is the recommendation that sole sponsored plans be required to provide grow-in benefits to any member who is involuntarily terminated, whereas MEPPs, JSPPs and Target Benefit Plans be exempt from that requirement.

essentially the same (e.g., in a jointly sponsored plan and a sole sponsored plan, the members' expectation is that they will receive the promised benefit levels at retirement). The purpose of a regulatory regime is to protect the delivery of accrued benefits. That purpose should be the same regardless of whether the model of plan allows accrued benefits to be reduced since members and pensioners will be just as adversely affected.

Also, there is no risk-based justification for a distinction based on form. There is no intrinsic reason to suggest that members are better protected under a jointly sponsored plan or a target benefit plan than under a sole sponsored plan. Indeed, one could make the case that the reverse is true. The point is that members and pensioners in all models and forms of plan need to be able to rely on their accrued benefit being delivered and that is what the regulatory regime should seek to accomplish.

Moreover, in at least some cases the Commission's recommended approach would lead to an unreasonable result from a consumer protection perspective as well as from a plan sponsor's perspective. The PSPP is not now required to include indexing in its solvency valuations but would be under the Commission's recommended approach. The PSPP is certainly lower risk from a consumer protection perspective than most existing jointly sponsored plans. To require the PSPP's sponsor to make solvency contributions on the more stringent basis would be unnecessary and would be punitive to the sponsor. Although it would have the power to do so, if the Government chose to adopt the Commission's recommendations, how could it exempt the PSPP from the stricter solvency funding regime?

The solvency funding requirements now applied to sole sponsored plans are not applied under the current regulatory regime to limited MEPPs. The conclusions we come to are that with a strong risk-based regulatory regime in place: (1) solvency ratios should be considered by the regulator as one of several measures to monitor risk in all plans; and (2) solvency funding requirements in their current form should not be applied to any model or form of plan.

We do not want to be taken as being focused narrowly on solvency funding. Our recommendation is that a comprehensive risk-based approach to protecting the accrued benefits in all types of plans be developed and adopted.

**OPB comments regarding the Commission's recommendations to encourage broader pension coverage for Ontarians**

We commend the Commission for exploring and ultimately recommending a solution to encourage broader pension coverage for Ontarians. It appears to us that the premise of the Commission is that, in the current environment, promoting coverage through traditional defined benefit plans is unlikely to result in a substantial increase in coverage. The Commission has clearly concluded that a more fruitful area of focus for reform in that regard is on multi-employer type plans. It would be reasonable for the Government to accept the Commission's premise.

In general, we support the Commission's recommendation relating to Target Benefit Plans. That model does capture a number of the advantages of traditional DB plans such as professional investment and plan management, a vehicle for low cost automatic annuitization and the possibility for the development of scale. Conversely, it avoids many of what we regard as extremely serious shortcomings of the traditional Defined Contribution (DC) model.

We do want to say that we remain of the view that the traditional defined benefit plan (whether sole or jointly sponsored in form) is the most efficient and effective model to deliver retirement security at a reasonable cost to all stakeholders. In our view, the Commission goes too far in recommending a regulatory environment that would actively discourage sole sponsored plans and in recommending conversion of those plans to jointly sponsored arrangements. We strongly recommend against the Minister adopting any approach that would create a regulatory environment that is effectively hostile to traditional defined benefit plans. We urge the Minister to include in any package of reforms, measures to improve the regulatory environment for such plans. We refer you to our submission to the Commission for our recommendations as to those measures. Times and conditions change. In the future, employers may wish to establish sole sponsored DB plans. If so, they should find a regulatory regime that is as friendly to that model and form as to any other.

In encouraging coverage through the Target Benefit Model, it is critical that the legislative framework include requirements that would protect the interests of individual plan members. A potential serious weakness in this plan model is that, absent protections for accrued benefits, members whose human capital is spent or largely spent are exposed to the risk of loss of a substantial portion of the benefit that they have come to expect and rely on. It is one thing for a 45 year old to lose a portion of an accrued benefit and to have to adjust their lives (and their working career) to that reality. It is quite another for it to happen to a 70 year old whose health may be failing and whose only option is a dramatically reduced standard of living.

The vast majority of traditional DB plans have been totally effective in preventing that from occurring to individuals whose human capital has been exhausted. There have been a small number of unfortunate exceptions. Our observation is that those might have been mitigated or avoided had a robust risk-based regulatory oversight regime, such as the type we recommend, been in place.

One mechanism might be to provide for protection of a progressively larger share of a member's accrued entitlement based on years to retirement. Others might include; (i) providing for some modest increase in employer contributions to an underfunded plan subject to a maximum level, (ii) for plans which provide future indexing, that might be put into abeyance until the plan recovered, or (iii) retirement dates for active members might be moved back. These would be measures that would be taken prior to reducing the accrued pension amount. We note that the research we attached with our submission to the Commission included discussion of the approach now being adopted in some

European countries that does provide for benefit adjustments but does so on a basis consistent with our recommendation.

We have one other point to make with respect to the critical goal of encouraging pension coverage. There is a great deal of evidence that collective models of plans offer many benefits to the economy and society at large. They should be strongly encouraged as a matter of public policy. In our view, there should be incentives created for employers to sponsor collective models of plans that meet certain criteria which would include professional investment management, an opportunity for scale, a vehicle for low cost automatic annuitization and professional and fiduciary management and governance.

### **OPB's Comment regarding the Commission's recommendations relating to plan Governance**

The implication of the Report is that the Commission regards the joint sponsorship/trusteeship of pension plans as a structure which is to be preferred or produces better governance. OPB strongly supports stakeholder participation in the governance of the administration of plans. We believe that stakeholder participation does improve governance. That does not mean that joint sponsorship/trusteeship is the only form that provides for appropriate stakeholder involvement or that it is a form that necessarily results in better governance than a sole sponsored plan. Governance excellence is a function of many factors including excellent principles, values, processes and people. There are many superbly governed sole sponsored plans. The PSPP is a sole sponsored plan. OPB as the Plan administrator has significant stakeholder representation on its Board of Directors. The governance of the PSPP meets the highest standards.

### **OPB's recommendation regarding the Financial Services Commission of Ontario**

The Report states that FSCO was "not operating as well as it should" and recommended a number of significant changes, including that FSCO be replaced by an all new "Ontario Pension Regulator" with the power to provide advance rulings and make rules, and that a number of other new agencies including the "Pension Tribunal of Ontario" and the "Pension Champion" be created. We think these are sound recommendations and would encourage the Government to implement them. In the current economic environment, it may be that the Government will conclude that it cannot implement these recommendations immediately.

In that event, we would urge the Government to move now, on an interim basis, to implement the objectives that underlie the Commission's recommendations. This could be done, in part, through FSCO. We believe that there are very capable and well-intentioned professionals at FSCO who do the best with what they have, but that FSCO does not have the proper mandate or sufficient resources to fulfill the role that we recommend for the regulator. We would suggest that the government focus on

implementing the following improvements (some of which were recommended in the Report):

- FSCO should be restructured so that the Pension Plans Branch operates under legislated, pension-specific guiding principles, is adequately staffed by individuals with the requisite level of expertise in pension matters, and has relatively broad policy-making powers within the framework set out in its legislated mandate (which would include the requirement to consult with industry stakeholders on pension policies as they are developed).
- The FSCO mandate should be amended to specifically include encouraging broad pension coverage in Ontario (this would be in addition to establishing at the earliest feasible opportunity, the Pension Champion as a separate body).
- The Pension Plans Branch of FSCO should be adequately resourced and its regulatory mandate should explicitly adopt the risk-based approach discussed above.

We also strongly agree with the Commission's recommendation for the creation of a vehicle to provide low cost annuitization for individual's savings. There are in Ontario several large public sector pension plans, such as Ontario Pension Board, that have particular expertise and experience with annuitization through the normal administration of their plans. The Government should consider using one or all of these plans as vehicles for this initiative.

A strong regulatory framework would enable reform measures to be carried out effectively and efficiently and should be considered in the government's reform package. It is also very important with respect to supporting the long-term viability of the pension system in Ontario. A strong framework requires a clear mandate from policy makers to ensure that the regulator has the powers and the resources to carry out good public policy.

#### **OPB's recommendation regarding leveling the regulatory playing field**

The Report does not directly address certain inequalities of the current regulatory system. Of particular concern to OPB is the lack of regulation of defined contribution plans. We are also of the view that group RRSPs should similarly be subject to the same regulatory requirements as we recommend for DC Plans. In our submission, we made a number of recommendations to address the irrational features of the current regulatory system which favour DC plans over DB plans. We believe that a review of the impact of the current financial market meltdown will demonstrate that, at an individual level, it has been exacerbated by inappropriate investment choices made by unsophisticated investors in DC plans who were badly advised. We urge the Minister to adopt our recommendations with respect to regulating DC Plans. Those included requiring DC plans to provide members with annual pension statements of expected retirement income based on objectively reasonable and disclosed assumptions, so that members have a clear view of the adequacy of their retirement savings level. We also encourage reform of these plans

to transition more of the investment decision-making to professional investment managers.

**OPB's recommendation regarding regulating financial advisors**

Although the Report included recommendations that the fiduciary duties of "professional advisors and agents" be considered and codes of best practice for such professionals be developed, the focus of the Report appears to be on actuaries and nowhere did the Report specifically address a key point raised in OPB's submission – the lack of regulation of financial advisors. OPB strongly believes that there is a need to protect DB plan members from financial advisors who benefit from the transfer of the DB assets out of the plan. Please refer to our submission for the rationale for OPB's recommendation.

**OPB's recommendation regarding the Quantitative Investment Rules**

In our submission to the Commission we recommended amendment of the *Pension Benefits Act* to remove the prescribed quantitative investment restrictions that impose unnecessary constraints and add cost, complexity and act as a disincentive to potential investment partners.

The Report recommends that the Ontario government "persuade the federal government to reform the investment rules". It is our view that the Province could and should move forward on its own initiative to make the necessary amendments to the PBA.

Those are our comments. Minister, thank you again for the opportunity to provide our comments to you. We would be pleased to meet with you or your staff to discuss any of our comments.

Sincerely,



Vincenza Sera  
Chair, Ontario Pension Board



Mark J. Fuller  
President & CEO