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The Association of Canadian Pension Management

L'Association canadienne des administrateurs de régimes de retraite

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ACPM Submission on Nova Scotia Draft Funding Regulations

ACPM CONTACT INFORMATION

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FOREWORD

<u>The Association of Canadian Pension Management (ACPM)</u>

The Association of Canadian Pension Management is the informed voice of Canadian retirement income plan sponsors, administrators and their allied service providers. We are a non-profit organization and our objective is to advocate for an effective and sustainable Canadian retirement income system. Our membership represents over 400 retirement income plans consisting of more than 3 million plan members, with assets under management in excess of $330 billion.

The ACPM promotes its vision for the development of a world-leading retirement income system in Canada by championing the following Guiding Principles:

- Clarity in legislation, regulations and retirement income arrangements;
- Balanced consideration of other stakeholders' interests; and
- Excellence in governance and administration

<u>Introduction</u>

The ACPM appreciates the opportunity to provide our input to the Department of Labour and Advanced Education (the "Department") on the Draft Regulations under the *Pension Benefits Act* ("Draft Regulations").

ACPM has made a number of submissions over the past few years to various Canadian jurisdictions, including Nova Scotia, that are embarking on similar reviews of their pension regulations and how to strengthen our broader retirement income system in Canada. The Canadian governments have an opportunity to work together in developing an environment where retirement plan coverage can increase but without posing a complex regulatory and administrative burden on plan sponsors and administrators.

In this brief you will find our general comments and suggestions on the Draft Regulations. Our comments are informed by our experience with Ontario's pension regulations, on which the changes in the Draft Regulations are primarily based.

Below we set out our comments on these issues and the Draft Regulations.

Harmonization of Pension Regulations

The ACPM supports and advocates for harmonization of pension legislation across Canada. It is very important for pension plan administrators with members in more than one province as it minimizes the costs and complexity of plan administration. The ACPM appreciates the Department's efforts to harmonize Nova Scotia's pension legislation with the pension legislation of the other provinces, in particular the province of Ontario.

We have seen evidence of this harmonization in the Draft Regulations under the following headings:

- Letters of Credit and Solvency Accounts
- Investment Regulation
- Phased Retirement
- Audited Financial Statements
- Transfer Deficiency Funding Requirement

Letters of Credit and Solvency Accounts

The ACPM applauds the change to the PBA that now permits prescribed employers to use letters of credit to fund pension solvency deficiencies.

As indicated in our submission of January 31, 2012, the ACPM also urges the Department to build on the funding flexibility provided by letters of credit by also enabling the use of *solvency accounts*, independent from the pension trust. A description of this approach was provided in our earlier submission. We believe that the solvency account approach could be even more effective than the letter of credit approach both in terms of cost and administration.

Investment Regulation

We understand that the new Schedule I for investments has been modeled after the regulation under the federal Pension Benefits Standards Act. We believe that it is important to keep these regulations in line with modern investment and risk management practice. It would be unfortunate if the quantitative limits imposed by the Schedule limited the flexibility of a pension administrator to best manage the investment risks of the pension fund. We would anticipate that the prudent management of the fund could be limited to retaining the requirement for the prudent person rule and the establishment and administration of the Statement of Investment Policies and Procedures. Rather than impose a Schedule in the Draft Regulations, a simpler alternative would be to refer to the PBSA Schedule (as amended from time to time) as a guideline upon which administrator should consider in developing its SIPP and in setting up the fund structure.

Phased Retirement

We have no comments on these sections of the Draft Regulations at this time.

Audited Financial Statement Filing

Under Section 24, audited financial statements would now be required to be prepared and filed. We anticipate that this would not be a significant requirement for larger plans, as many would already be conducting such audited financial statements. For small and medium sized pension plans, the cost of preparing an audited financial statement could be a significant, and arguably without any material enhancements to the security of pension benefits. This is especially so for pension funds invested solely in pooled funds which are already audited at least annually in accordance with the principles and standards set out in the Handbook of the Canadian Institute of Chartered Accountants. This issue appears to be recognized by the exemption granted in subsections 24(3)(a) and 24(3)(b)(i). We would suggest that the exemption be further expanded or clarified by revising the wording in 24(3)(b(ii) to:

"(ii) in pooled funds or exchange traded funds which are audited, at least annually, in accordance with the principles and standards set out in the Handbook of the Canadian Institute of Chartered Accountants"**.**

Also, we wonder whether the power in subsection 24(2) to shorten the reporting period is necessary. It may in fact not be practical for an auditing firm to prepare an audited financial statement much sooner than six months from the fiscal year end due to the time it takes to collect the information and supporting documentation and complete the necessary analysis.

Transfer Deficiency Payment Requirements

We welcome the efforts to harmonize the materiality threshold under subsection 49(9)(b). This will lessen the administrative burden particularly with transfer value payments that are relatively small in comparison with the total plan assets.

As noted in our previous submission, there remains an inconsistency with the transfer ratio calculation (which includes grow-in) and transfer values which more frequently do not include the value of grow-in benefits. This inconsistency exaggerates the size of the actual transfer deficiency. To remedy this situation, by clarifying that the transfer ratio referenced in subsection 49(4)(a) can be modified to remove the value of the grow-in benefits not included in the former member's transfer value.

We believe that subsection 49(7) may not be necessary given the existence of subsection 49(6). The materiality subsection 49(9)(b) would most probably suffice in cases where the ratio dropped from above 1 to somewhere in between 0.9 and 1. We are concerned about the burden and responsibility on the Superintendent's office to provide the approvals under subsections 49(6), and (7).

Rather than deny the prompt payment of benefits to beneficiaries upon termination of employment and death, perhaps a prompt notice to the Superintendent's office would suffice. If the Superintendent's office deemed it necessary, it could order the administrator to have an updated solvency ratio prepared. In order to reduce the financial burden on the plan and the time required to prepare the ratio, consideration could be given to using a reasonable extrapolation of the solvency liabilities.

Innovation

We noted that the government has shown innovation and foresight in the following new sections:

- Variable pensions
- Advisory Committee
- Retention of records

Variable pensions

For those administrators who agree to the extra administrative burden, ACPM believes that this new provision could represent a very valuable benefit. Where expense ratios are substantially less than those involved in a retail product, this approach could significantly extend the period during a sustainable income level might be provided. There are a few areas, the Department may wish to consider in these Regulations:

- *Default provisions*: In order to streamline administration and make this new feature more user friendly, the Department may wish to consider defining a number of defaults, such as the frequency of benefit payments (*e.g.* monthly), default amount (*e.g.* minimum amount for the first year and for subsequent years, the benefit amount paid in the previous year). Alternatively, these defaults could be established by the plan document.
- *Pro-rating maximum amount*: We wonder if a subsection similar subsection 7 of the LIF Schedule should also be incorporated into the subsection 64.
- *Voluntary (non-locked amounts)*: We believe that subsections 61(e) and 61(f)(ii) should not apply to the portion of the variable benefits account attributed to transfers from a voluntary account or non-locked in transfers into the variable benefits account under subsection 62(1)(e).
- *Income Tax Act requirement to commence retirement income:* The Department may wish to recognize this requirement by defaulting the transfer of the remaining balance of the defined contribution account to the variable benefit account upon reaching the date prescribed under the *Income Tax Act*.
- *Annual Statements*: Unless there is an automatic monthly benefit payment feature, we suspect that 60 days may be too long for the participant to receive his annual statement and elect his / her benefit amount for the year. Once automated, we would anticipate that the statement could be provided within 15 days of the end of the calendar year.
- *Right to purchase an annuity*: One of the risks that retirees must manage is longevity risk. It could be helpful to remind retirees using the variable benefits feature of their right to purchase a lifetime annuity. A notice could be included in the annual benefit statement.
- *Spousal benefit option*: Under the existing Act and Regulations, upon death, benefits payable to a spouse or common-law partner would not be locked-in. Accordingly, we question whether subsection 61(2) should be clarified to indicate that the variable benefit account would no longer be locked-in.
- *Typo*: Subsection 62(2)(b) refers to the term “purchaser”. We suspect the Department meant to use the phrase “member or former member”.
- *Information provided before election*: In order to provide the member with appropriate information in order to make an informed choice on whether to elect the variable benefits payment option, life annuity or LIF transfer, it would be useful to provide an explanation of the terms and conditions of the variable benefit option, including but not limited to:
  - Investment options and estimated expense ratios, so the member can compare these with those of retail LIF products;
  - A statement confirming the retiree continues to face investment risk and longevity risk so long as he / she uses the variable benefit account;
  - A statement indicating that neither LIFs or the variable benefit feature guarantee an income for life;
  - A statement confirming the retiree’s right to purchase a life annuity, now or in the future; and
  - A statement confirming the retiree’s right to subsequently transfer his / her variable benefit account to a LIF, LIRA or life annuity.

We believe that it is reasonable for the administrator to require the retiree to acknowledge and accept in writing that he / she the above statements and terms and conditions of the variable benefit account option.

Advisory Committee
We noted the expanded regulations and their attempt to provide additional structure to the formation of an advisory committee. We believe that the language should support both the administrator and the employees by providing a reasonable starting framework, and without unnecessarily limiting the flexibility of the operation of such committees or increasing the administrative burden.

Retention of Records
We agree that it is important for any plan to have a formal retention policy. We believe these minimum requirements provide a good structure for a records retentions policy. We suspect that administrators may have to go further than the minimum requirement and will also have to take into account privacy concerns.

Surplus Ownership Confusion

Claim to Surplus on Wind-up
We note that subsection 76 lays out detailed information to be provided to participants and beneficiaries who may become eligible to a portion of the surplus. We are concerned, however, that the language used may suggest the surplus ownership is automatically given to participants and beneficiaries in favor over the plan sponsor, despite the documents supporting the pension plan. The language as written may have the unfortunate effect of causing employers to reduce their funding to the absolute minimum for fear of losing their entitlement to surplus in the event of a plan wind-up.

Assuming that it was not the intention to override the plan's supporting documents by granting surplus to plan beneficiaries we would suggest a modification to subsection 76(1) as follows:
"(1) This section applies if there is a surplus on the wind-up of a pension plan in whole or in part and the plan beneficiaries have an entitlement to some or all of the surplus."

Subsection 76(2)(c) could also be modified to clarify the distribution method between the sponsor and plan beneficiaries and between the plan beneficiaries themselves. For example, the wording could be revised as follows:
"(c) the method for distributing the surplus between the employer and the plan beneficiaries and the method for allocating the plan beneficiaries' portion of the surplus"

Conclusion
We appreciate the opportunity to provide our comments on the Draft Regulations. We would be pleased to make ourselves available to respond to any further issues that arise through the consultation process.