ACPM Response to New Brunswick Task Force on Protecting Pensions

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ACPM/ACARR

The Association of Canadian Pension Management

L'Association canadienne des administrateurs de régimes de retraite

ACPM CONTACT INFORMATION

Mr. Bryan Hocking
Chief Executive Officer

Association of Canadian Pension Management
1255 Bay Street, Suite 304
Toronto ON M5R 2A9
Tel: 416-964-1260 ext. 225
Fax: 416-964-0567
Email: bryan.hocking@acpm.com
Web: www.acpm-acarr.com

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FOREWORD

The Association of Canadian Pension Management (ACPM)

The Association of Canadian Pension Management (ACPM) is the informed voice of Canadian pension plan sponsors, administrators and their allied service providers. Established in 1976, the ACPM advocates for an effective and sustainable Canadian retirement income system through a nonprofit organization supported by a growing membership and a team of volunteer experts. Our members are drawn from all aspects of the industry from one side of this country to the other. We represent over 300 pension plans consisting of more than 3 million plan members, with total assets under management in excess of $300 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

Introduction

The ACPM appreciates the opportunity to provide our input to the New Brunswick Task Force on Protecting Pensions. In this Brief you will find our general comments and suggestions regarding risk management practices and the long term sustainability of pension plans as well as measures to promote pension coverage in New Brunswick.

ACPM has made a number of submissions over the past two years to various Canadian jurisdictions that are embarking on similar reviews of their pension regulations and how to strengthen our broader retirement income system in Canada. We refer to our submission to New Brunswick's Retirement Income Adequacy Consultation in May 2010 (copy attached) as our specific recommendations made at that time still apply.

We support New Brunswick's latest efforts in this regard and applaud your intention to examine practices and structures adopted by other Canadian jurisdictions in as far as that leads to a more uniform regulatory landscape for pension plans across the country.

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.

1. Need for Harmonization

Harmonization of pension legislation is very important for pension plan administrators with members in more than one Maritime province as it minimizes the costs and complexity of plan administration. There is now a unique opportunity to harmonize legislation throughout the Maritime Provinces. Both Nova Scotia and Prince Edward Island are currently in the process of reviewing and revising their pension legislation. Nova Scotia has indicated that its legislation will largely follow Ontario's legislation and may be introduced in the fall session of the Legislature. PEI has indicated that its legislation will largely follow Nova Scotia and will be introduced after Nova Scotia's legislation is introduced. Working with the other two provinces, New Brunswick can achieve a harmonization of its legislation with Nova Scotia and PEI, as well as Ontario. Therefore, we urge this panel to recommend that New Brunswick legislation be harmonized with that of Nova Scotia and PEI as pension reform unfolds in these provinces.

2. Risk Management Practices and Long-Term Sustainability of Pensions Plans

The Task Force identified a number of perceived 'root causes' of pension plan challenges. We are uncertain what link the shift in employment to emerging economies has to pension instability; however, we do note that easing regulatory burdens, including those relating to establishing and maintaining employee pension plans, would be consistent with policies to encourage greater employment and economic development in the province. Legislated risk management practices cannot be so onerous that they further discourage employers from establishing or continuing with their pension plans. Moreover, implementing policies that are unique to New Brunswick would not facilitate new business or new pension plan development in the province.

(a) Risk Asymmetry

The ACPM believes that one of the principal causes of pension plan instability and the decline in pension plan coverage, especially in the private sector, is the risk/reward mismatch in the defined benefit (DB) pension system. Funding a plan into a modest surplus position is an effective risk management policy where surpluses provide a buffer against adverse plan experience. However, the current regime where plan sponsors are generally responsible for funding shortfalls but are severely constrained from accessing surpluses, is the major impediment to not only the funding of private sector DB pension plans but to their continued existence.

Adopting a reasonable and efficient solution to surplus ownership issues is key to the success of any reform to pension legislation. Legislation should establish that pension plans are employment contracts and that ownership of pension funds is governed by those contracts, thereby achieving clarity and avoiding any surplus disputes. Legislation should also contain principles-based provisions requiring that surplus and deficit "ownership" be clearly defined in plan documents. Surplus entitlement rights must be clarified and plan sponsors must be able to adopt a "fresh start" approach to the new rules. In addition, it would be beneficial to allow plans to confirm their surplus sharing provisions where earlier versions of their plan documentation were silent on the matter.

Ring-fencing, as proposed by the Alberta-British Columbia Joint Expert Panel on Pension Standards, is also an interesting approach.

(b) Letters of credit

ACPM fully supports allowing the use of letters of credit (LoCs) as a partial alternative to cash funding as they are a flexible option for plan sponsors to deal with the volatility of solvency valuation results. They are also an effective way to secure plan benefits and possibly avoid the growth of excessive surplus in the future. However, they are not available to all plan sponsors for a variety of reasons: corporate structure, plan design (e.g. multi employer pension plans), lack of credit availability, etc.

(c) Solvency accounts

As a compromise solution to the conflict between risk-reward asymmetry and benefit security in DB plans, we propose that sponsors have the ability to set up a solvency account, independent from the pension trust. This also addresses some of the drawbacks of LoCs. Going concern funding contributions would continue to be paid to the main pension fund. Where the employer is the sole contributor to the pension plan, or where the employee contributions are fixed, further employer contributions required under the solvency valuation could be paid to the solvency account. However, similar to the pension fund, the solvency account would be segregated from the employer's assets, tax-sheltered, and protected from non-pension creditors. Upon plan windup, any assets in the solvency account not required to satisfy benefit entitlements would revert back to the employer. In an ongoing situation, assets in the side account could be accessed by the employer only if the sum of the assets in the pension fund and the side account exceed the plan's solvency valuation obligation. Employers would be able to make additional contributions above the going concern minimums to the solvency account. The ability to make these additional voluntary contributions will provide employers with greater flexibility to manage their cash requirements within their own business cycles and would lead to enhanced benefit security for plan members.

(d) Eliminate Quantitative Limits on Investing

ACPM recommends holding pension investments to the standard of a prudent person and eliminating all quantitative limits on investing. Studies have consistently shown that such restrictions, by limiting the pool of available assets, have a negative impact on pension fund performance. By doing this, benefit security will continue to be protected as a wider investment set will be available for the funding pool of assets in the pension plan.

ACPM also encourages the Task Force to recommend that the federal investment rules be adopted by New Brunswick as all other jurisdictions except Quebec have done.

(e) New Risk-Sharing Plan Designs

In the classic DB pension arrangement, the burden of investment and actuarial risks is largely borne by the employer, while in DC plans these risks are largely transferred to the employee. However, in between these extremes are many examples of hybrid risk-sharing or flexible plan arrangements. Multi-employer pension plans are an example that allow participating employers the certainty of contribution that DC plans provide, while providing some target level of benefit to employees while still dependent on financial performance of the plan.

ACPM supports the recommendations contained in the Ontario Expert Commission on Pensions (OECP) report, and similar reports released by the Alberta/British Columbia Joint Expert Panel on Pension Standards and the Nova Scotia Pension Review Panel, to expand the use of target benefit pension plans for single employers as an alternative to traditional defined benefit (DB) and defined contribution (DC) plans. We believe that the single-employer target benefit plan design would have significant appeal for many employers and their employees as it has the above interesting characteristics of multi-employer DB pension plans without the necessity of partnering with other employers. The ACPM encourages the Task Force to consider broader plan designs such as target benefit plans and more regulatory flexibility to support these designs.

(f) DC Plans – Safe Harbour

As ACPM has indicated in other submissions we are in favour of allowing administration of DC plans to be on a "good faith" standard of care or make provision for a safe harbour in appropriate circumstances. In those circumstances provincial pension legislation should recognize the Capital Accumulation Plan (CAP) Guidelines as providing a standard that is acceptable to legislators and thereby provide the comfort needed by plan sponsors and administrators.

3. <u>Other Measures to Promote Coverage in New Brunswick</u>

Various issues have contributed to the decline in pension plan coverage in Canada, especially in the private sector. Such issues include the uncertain legal and regulatory environment, the risk/reward mismatch in the defined benefit system (as described above under Risk Asymmetry), the negative impact of accounting standards, the cost and complexity of plan administration, and the legal risks associated with administering private pension plans. New Brunswick, together with the other provinces and the federal government, need a vibrant system that encourages employers to offer pension plans to their employees. In particular, the current system needs fixes in order to offer a positive environment for the implementation, maintenance and improvement of defined benefit pension plans. Canadian governments have an opportunity to work together in developing an environment where retirement plan coverage can increase, but without imposing a complex regulatory and administrative burden on plan sponsors and administrators.

Key changes to the current framework governing workplace pension plans are required. Such changes include revising pension legislation and guidelines to expand the definition of administrator and sponsor, permit a good faith standard of care in the administration of DC plans or a US style safe harbour (as noted above), remove requirements for similar benefits per class of plan member and accept the use of electronic communications. In addition, changes to employment standards legislation (to, for example, contemplate automatic pension enrolment and auto-escalation of DC contributions with opt-out) could also assist to increase pension coverage in New Brunswick.

4. <u>Final Comment</u>

We appreciate the opportunity to provide our input to the Task Force on these very important issues. We look forward to providing feedback on the Task Force's interim report when it is release.