ACPM SUBMISSION TO THE PROVINCE OF NOVA SCOTIA MINISTRY OF LABOUR & EDUCATION

ACPM Comment on Draft ***Pension Benefits Regulations***
Made Under the ***Pension Benefits Act***

Prepared by:
ACPM National Policy Committee
January 31, 2012

ACPM/ACARR
The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

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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 non¬profit 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 400 pension plans consisting of more than 3 million plan members, with total 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

Introduction

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

ACPM has made a number of submissions over the past two 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 funding rules, on which the Draft Regulations are primarily based. In addition to our comments on the Draft Regulations, we also wish to stress in this Brief the urgent need to offer funding relief measures to private pension plan sponsors in Nova Scotia in 2012 and for harmonization of pension legislation across Canada.

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

Need for Harmonization

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 with the pension legislation of the other provinces and, in particular, the province of Ontario.

Need for Private Pension Plan Funding Relief Measures in 2012

In response to the last economic downturn in 2008, Nova Scotia (like many other Canadian jurisdictions) offered temporary funding relief for private defined benefit pension plans. Those relief measures included permitting new and existing solvency deficiencies to be amortized over 10 years (instead of the usual five years) for the first valuation with an effective date between December 30, 2008 and January 2, 2011.

Since these funding relief measures were last offered, plan sponsors in Nova Scotia as well as in other Canadian jurisdictions have been waiting and hoping for economic improvements before their next triennial valuation due after January, 2011. However, a combination of continued declining long-term interest rates and poor equity markets have resulted in larger plan deficits at the end of 2011 and will no doubt lead to higher pension costs in 2012 and beyond.

In response to these current economic conditions, Québec has issued a draft regulation that will provide funding relief to private sector defined benefit pension plans registered in that province. Under the draft regulation, the funding relief measures will apply starting with the first complete actuarial valuation having an effective date after December 30, 2011, and generally ending at the end of a plan's first fiscal year beginning after December 31, 2012. It includes three funding relief measures applicable to the solvency valuation – plan asset smoothing over a maximum period of five years; at the time of the first valuation covered under the relief measures, consolidation of solvency deficiencies, other than those related to an amendment made after December 30, 2008; and extension of the amortization period from 5 to 10 years for the new solvency deficiency. Funding relief measures such as those proposed by Québec will help private plan sponsors deal with the impact the current economic environment has had on their registered pension plans. We note that other provinces such as New Brunswick, Newfoundland and Manitoba are also offering solvency funding relief under their pension legislation in 2012. ACPM strongly urges the Department to offer similar measures for Nova Scotian plan sponsors in 2012.

Jointly Sponsored Pension Plans

The ACPM acknowledges the efforts of the Department to promote flexibility in pension plan design by introducing the jointly sponsored pension plan ("JSPP"), a plan co-sponsored and co-managed by the employer and employees. However, in respect of the draft funding rules that will apply to JSPPs, we have the following comments.

<u>80% Funding Threshold</u>

The ACPM recommends that the solvency funding exemption under the regulations extended to Specified Multi Employer Pension Plans ("SMEPPs") be available to JSPPs. SMEPPs and JSPPs share certain characteristics such as risk sharing. However, the Draft Regulations provide that JSPPs must be funded on a solvency basis to a threshold of 80% of liabilities. In order to promote flexibility in funding these plans and to properly recognize the similarities between JSPPs and SMEPPs, we strongly recommend that this 80% threshold be eliminated and JSPPs be exempt from the solvency funding requirements under the regulations (as Ontario has done in respect of Ontario JSPPs).

The proposed 80% funding threshold is also problematic in that it could place an enormous burden on the active members of a JSPP to fund the members' portion of a solvency deficiency of which the liabilities for inactive members represent a substantial portion. When combined with the prohibition on reducing accrued benefits while the JSPP is ongoing, the 80% solvency funding threshold will result in inequity among former and current plan members while the JSPP is ongoing. This requirement makes the implementation of JSPPs in Nova Scotia less palatable for Nova Scotia employers and employees.

In summary, in order for the JSPP to be a viable option for Nova Scotia employers and employees, the regulations must exempt these plans from solvency funding (just as Ontario's regulations do for Ontario JSPPs).

Benefit Security Alternatives

The 80% solvency funding threshold is intended to, among other things, provide long term security for JSPP plan members. For the reasons addressed above, JSPPs should be exempt from solvency funding. Instead, the Department may wish to consider other measures to address the security of members' benefits in these plans. Such measures may include shortening the amortization period for funding going concern deficits in these plans and/or imposing restrictions on benefit improvements. These alternative methods of enhancing benefit security would be preferable to the solvency funding requirement.

Letters of Credit

As an alternative, if the Department considers it appropriate to maintain the 80% solvency funding threshold, the ACPM strongly encourages the Department to permit letters of credit to be available to JSPPs, with the consent of the sponsors, to assist in managing and securing the solvency funding obligations for these plans.

JSPP Election

Section 7(1) of the Draft Regulations requires the plan administrator to make the election that a pension plan is a JSPP. This election should be made by the sponsors of the JSPP, as the design of a pension plan is clearly within the discretion of the plan sponsors, not the plan administrator. This election by the sponsors of the JSPP is also consistent with section 98 of the Pension Benefits Act (the "PBA"), which requires the sponsors of a JSPP to elect as to whether grow in benefits will be provided under the plan.

In addition, Section 7(5) requires that the administrator's JSPP election be filed no later than the date on which the first valuation report for the plan is submitted after the effective date of the Draft Regulations. We are concerned that this provision unduly restricts plans to a narrow window of time in which to make such an election and we do not see a policy basis for setting such a time limit.

Specified Multi-Employer Pension Plans (SMEPPs)

The Draft Regulations extend solvency funding relief to specified multi-employer pension plans (SMEPPs) provided they meet the criteria set out under subsection 9(1) of the Draft Regulations. It appears that the criteria generally mirror those of the specified Ontario multi-employer pension plans (SOMEPPs) regulations in Ontario. The SOMEPP criteria under the regulations to the *Pension Benefits Act* (Ontario) were based on the criteria set out under the Income Tax Act Regulations for SMEPPs under that Act. In the ACPM's view, two criteria should be revised.

First, the criterion that requires that to be a SMEPP all or substantially all of the employers who make contributions to the plan must be "persons who are not exempt from tax under Part I of the Income Tax Act (Canada)". The effect of this provision is that all or substantially all of the employers participating in a SMEPP cannot be tax exempt entities. In ACPM's view, any employer, whether it is a tax-exempt entity or a tax paying entity, should be able to participate in a SMEPP and it should not make any difference as to whether the plan may be entitled to solvency funding relief.

Second, the criterion that "all employers make contributions to the plan pursuant to one or more collective agreements", also unduly limits participation in SMEPPs to unionized employers. We encourage the Department to revise this criterion to allow participation of non-unionized employers by permitting the contribution obligation to the plan to be set out in other types of agreements, such as participation agreements. It should be sufficient for the contributions to be fixed in an agreement that is binding upon the participating employers.

Prior Year Credit Balance

Subsection 12(10) of the Draft Regulations allows an employer to apply a prior year credit balance determined under subsection 14(10) to reduce payments required under clauses 12(4)(b),(c) and (e). The same provision currently exists under Ontario's funding rules. However, the Financial Services Commission of Ontario ("FSCO") views this provision as the only situation where an employer can take credit for contributing more than the minimum required under the regulations during a prior year. As a result, FSCO will not permit an employer to draw on excess contributions made in a prior year unless those excess contributions are quantified in an actuarial valuation that is filed with FSCO.

In order to encourage employers to make contributions that exceed the minimum contributions they are required to make to their pension plans, the ACPM urges the Department not to adopt FSCO's approach and instead revise the Draft Regulations to clearly permit employers to benefit from any excess contributions during the interim period and not have to wait until the next valuation is completed before it can apply the credit towards required contributions.

Solvency Funding of Escalation Adjustments

In the 1980's Canadian pension regulators recognized the importance of recognizing the impact of inflation on the lives of pensioners and beneficiaries. In an effort to promote provisions to protect pensioners against inflation some pension regulators enshrined in legislation features that would encourage plan sponsors to plan for and communicate their intentions to periodically adjust pensions by only requiring them to fund those provisions on a going concern basis rather than a terminal funding basis for going concern plans. Indeed, in Ontario's recent revisions to its pension regulations it maintained this allowance for funding escalation adjustments. While it is recognized that plan terms can be structured to provide adjustments on an *ad hoc* basis, this approach would most likely lead to fewer adjustments, especially in the current economic environment and the general financial state of pension plans.

We would encourage the Department to consider the historical flexibility of the former funding requirements of escalation adjustments and to instead focus on the communication of the solvency funded status of pension plans to plan participants, pensioners and beneficiaries. If given the choice, active members may prefer disclosures of the potential loss of escalation adjustments in the event a plan is terminated (with an insolvent sponsor in the case of single employer plans) over the elimination of automatic escalation adjustments for future service. An alternative approach could be to codify the priority of payments of a terminated plan without resources to eliminate the deficit. Nominal payments could receive higher priority over escalation adjustments thus reducing the immediate impact on pensioners and beneficiaries in these infrequent events. In an era where defined benefit plans continue to struggle to exist, perhaps it is preferable to change the message on the security of escalated adjustments rather than to force even stricter funding requirements.

Transfer Ratio Definition

Under the Draft Regulations, the transfer ratio is defined as including any benefits or contingent benefits that were excluded in the solvency valuation. The result is that plan sponsors with insolvent pension plans who wish to facilitate immediate payment of commuted values on termination of employment may be required to remit transfer deficiency payments that account for items like grow-in benefits, special allowance benefits and prospective benefits to which ultimately the former member is not entitled. The result of this approach will lead to an improvement to the transfer ratio rather than keeping it neutral, which appears to be the intention of the transfer deficiency payment provisions.

We ask that the Department consider revising the definition of the transfer value by modifying the transfer ratio calculation for that purpose by only including in part (b)(ii) the benefits excluded in the solvency calculation to which the former member is actually entitled.

Letter of Credit Regulations

The ACPM applauds the change to the PBA that now permits prescribed employers to use letters of credit to fund pension solvency deficiencies. However, as the implementation of these letters of credit provisions is dependent on amendments to the Regulations under the PBA, we request that the Department finalize and release the amendments as soon as possible.

Solvency Accounts

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 solvency account would be a separate pension fund. 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 solvency account could be accessed by the employer only if the sum of the assets in the pension fund and the solvency account exceed the plan's solvency valuation obligation, including any appropriate margin. 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.

A solvency account also addresses some of the drawbacks of letters of credit. In some respects a solvency account is preferable to a letter of credit. Instead of the administrator holding a letter of credit issued by a financial institution, the administrator holds cash in the solvency account. This cash may be invested and earn a return, unlike a letter of credit. As well, the fees associated with the letter of credit may be substantial. These fees are avoided if a solvency account is used. A complete discussion of the concept of solvency accounts is found in the Alberta-British Columbia pension reform panel report. [1]

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[1] Getting our Acts Together – Pension Reform in Alberta and British Columbia, Report of the Joint Expert Panel on Pension Standards

Both approaches – the letter of credit and solvency accounts – are useful in various circumstances. ACPM urges the Department to increase funding flexibility by enabling both approaches to funding a portion of any solvency deficit.

Solvency Valuations – Solvency Asset Adjustment

ACPM notes that the calculation formula for the solvency asset adjustment in s. 3(1) of the Draft Regulations does not appear to allow an administrator to consider the present value of any existing or new going concern payments to be made during the solvency amortization period. This is a departure from current practice and would result in plan sponsors contributing twice towards the same deficit, at least in part. Since this has not previously been raised, and there would not appear to be any policy basis for this approach, we expect that this may well be an oversight. We draw this to the Department's attention so that it may be addressed.

Single Employer Pension Plans

Ensuring greater retirement income coverage and sufficiency is a public policy priority. Bill 96 and the Draft Regulations do not presently offer any real reforms that will support single employer sponsored pension plans. Workplace pension plans offered by employers are an important tool. The Draft Regulations offer limited support in permitting solvency liability smoothing. However, this is counteracted by the requirement to fund escalated adjustments for service after the effective date of the regulations. These submissions offer some additional suggestions of greater flexibility that will support the public policy goal of greater retirement income coverage and sufficiency. ACPM re-iterates that given the current historically low long term interest rates and challenging investment markets, additional solvency funding relief, whether on a short term basis or a longer term basis, will be needed.

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.