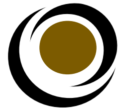

ACPM/ACARR

The Association of Canadian Pension Management

L'Association canadienne des administrateurs de régimes de retraite

BRIEF TO THE

ALBERTA-BRITISH COLUMBIA JOINT EXPERT PANEL ON PENSION STANDARDS

Friday, February 29, 2008

Prepared by the
ACPM Advocacy & Government Relations Committee
Alberta and British Columbia JEPPS Task Force

ACPM JEPPS TASK FORCE CO-CHAIRS

Ms. Rosalind Gilbert
Chair, ACPM B.C. Regional Council
Senior Consultant, Pensions
Aon Consulting Inc.
Tel: 604-892-5117
Rosalind.gilbert@aon.ca

Ms. Shirley McIntyre
Member, ACPM Alberta Regional Council
Director, Pensions
TransAlta Corporation
Tel: 403-267-4741
Shirley_mcintyre@transalta.com

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

TABLE OF CONTENTS

Foreword 3

Section 1.0 Introduction and Overview... 4

Section 2.0 Occupational Pension Plans in the Canadian Economy................ 6

Section 3.0 Pension Standards Legislation – Past, Present and Future 10

Section 4.0 Broad Pension Policy Issues 14

Section 5.0 Specific Elements of the Standards...................................... 16

Section 6.0 Related Legal Frameworks.. 22

Section 7.0 Your Issues 26

FOREWORD

Introduction

This brief is submitted on behalf of the Association of Canadian Pension Management (ACPM) by a joint Alberta and British Columbia Regional Council task force of ACPM's Advocacy and Government Relations Committee (AGRC). It was prepared in response to the December 2007 discussion paper entitled *"A Better Pension system for the Future: Finding a Balance"* issued by the Alberta-British Columbia Joint Expert Panel on Pension Standards ("the Panel").

ACPM commends the creation of the Panel and its Discussion Paper. We are pleased that it focuses on practical solutions that seek a balance amongst pension stakeholders. In particular, we see this initiative as a step to further the competitive advantage of British Columbia and Alberta which began with the signing of the Trade, Investment, and Labour Mobility Agreement in 2006. B.C. and Alberta have an opportunity to lead the country in developing an environment where retirement plan coverage can increase but without posing a complex regulatory and administrative burden on plan sponsors and administrators. We look forward to participating in this new regime.

The Association of Canadian Pension Management (ACPM)

The 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. The ACPM currently has 570 Individual Members and 23 Institutional Members across Canada, representing more than 300 pension plans covering approximately 3 million plan members.

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

The ACPM regularly advocates and participates in public dialogue on pension issues.

Section 1.0 Introduction and Overview

The British Columbia and Alberta Regional Councils of ACPM formed several joint subcommittees to respond to each section. As a result, the Panel will note that the sections vary slightly in style and that some issues and recommendations appear in more than one section. What is consistent is that each section aims to be well-reasoned and thoughtful and addresses the Panel's questions.

We have responded to the discussion paper as it was presented – in seven distinct sections. In each section we provide some introductory comments followed by specific responses to the Panel's questions. Our detailed responses are built on the following five fundamental principles:

Single Regulatory Regime – We support the creation of a single regulatory system for pensions in Alberta and B.C. with one set of rules and principles. Under this structure, there could be a single regulator or separate regulators administering the rules for each jurisdiction. This would be a good first step towards a single national regulatory system.

Increased Pension Coverage – Between 1992 and 2005, the Canadian workforce grew by 26% while the percentage of workers with access to an employer-sponsored pension plan declined from 50% in 1992 to 32% in 2006. In Alberta, the 2006 percentage was slightly lower at 30% and in B.C., slightly higher at 35%.

Decreasing occupational pension plan coverage has broad social implications. As our citizens enjoy longer life, we want them to be financially independent in retirement, not reliant on the Canadian welfare system. Increased retirement savings plan coverage is thus a desirable policy objective.

In this paper we promote a legislative environment amenable to occupational pension plans. We do not support mandatory employer sponsored plans. We support expanded coverage which would include having employees who are not currently in an occupational plan to be covered by any type of employer sponsored retirement savings arrangement, including a Group RRSP.

Clarified Regulation/Legislation - In an environment where the creation of retirement plans is voluntary, it is critical that potential sponsors' administrative requirements be simple and affordable. We promote the idea of moving pension plans from the broad trust law environment to a regime where the pension deal is struck between employers and their employees. The role of standards, regulations and legislation should be to secure the pension deal. We recommend a "fresh start" approach to implementing this change (i.e., new plans are under the new rules, existing plans can transfer to the new regime subject to certain conditions).

We believe it is time to move from rules-based, prescriptive legislation towards some principles-based regulation where guidelines are developed within which the regulators administer occupational pension plans. Plans and plan sponsors that are "at risk" will receive more attention. Financially sound plan sponsors with a history of good governance, compliance, and adequate funding would receive little attention.

Harmonization is easier to achieve under principles-based regulation. Alberta and B.C. have the opportunity to take the first step.

Flexibility – We promote a regulatory environment that allows flexibility in plan design, funding methods, investment strategies, and other aspects of operating an occupational pension plan. We traditionally think in terms of defined benefit or defined contribution plans; we encourage

the regulators to make changes to accommodate new plan designs that transcend those definitions, so that sponsors can design and manage plans to meet their particular requirements without legislative restrictions.

Continued Leadership – Alberta and British Columbia pension regulators have been open to discussions of change with plan sponsors. In Alberta, input and feedback have been sought from industry associations such as ACPM and from plan sponsors. Alberta has also taken a leadership role in lessening bureaucracy and providing flexibility. The recent move to allow letters of credit is a clear move towards giving plan sponsors improved flexibility in administering pension plans.

We encourage further leadership from Alberta and B.C. to continue this pattern. We further push Alberta and B.C. to lobby for removal of barriers to broad pension plan coverage that exist in other legislation, e.g., income tax legislation.

Section 2.0 Occupational Pension Plans in the Canadian Economy

The fundamental principles noted in Section 1 were used as a guide in the answers to the Section 2 questions.

2a. What role, if any, should occupational pension plans play in the Alberta and British Columbia retirement income system?

Occupational pension plans form an important part of the retirement income system in Alberta and British Columbia, and are well deserving of the governments' support and attention. However, we strongly believe that pension plans should not be imposed upon employers.

For members of occupational pension plans, the resulting pension income is often the largest single source of funds in retirement. Participation is normally mandatory for eligible employees. As a result, participating employees save a larger portion of their earnings (whether through employer or employee contributions) than they are likely to have saved without compulsion.

Employers must be free to choose the type of pension plan design that best suits their financial and human resource needs, to negotiate plan design, or to sponsor no pension plan at all. Public policy in this area is best served by removing disincentives to sponsoring occupational pension plans.

2b. What role, if any, should occupational pension plans play in attracting and retaining the future workforce and facilitating worker mobility?

Within the broad context of compensation, benefits and work environment issues, pension plans do play a role in attracting and retaining workers, particularly older workers. However, other factors, including cash compensation, work environment, and perceived opportunities for career advancement play a much larger role in an employee's decision to join or remain with a particular employer.

Single employer plan design should be allowed to be focused on specific employer objectives, and might have lower or higher focus on not penalizing worker mobility depending on the industry. Multi-employer pension plans do facilitate worker mobility and, in fact, were established as a response to existing high mobility of workers in a particular sector of the economy (e.g., construction trades) rather than as a tool to promote worker mobility.

2c. How can pension standards contribute to the competitiveness of Alberta and British Columbia with other jurisdictions in the global economy?

A single pension regulatory regime or harmonization of the provincial pension legislation would be the best way for pension standards to contribute to the competitiveness of AB and B.C. with other jurisdictions in the global economy.

It makes no sense to have slightly different pension benefits legislation in 10 provinces and 3 territories in Canada. There should be one act for all of Canada. B.C. and Alberta have the opportunity to lead by example by establishing a single regime for both provinces.

2d. To what extent can or should the governments deal with the issue of sufficiency of retirement incomes and how?

Current media stories highlight the extent to which RRSPs are underutilized, the discretionary spending pressures that individuals face, and the lack of understanding of the average Canadian as to what is actually required to provide an "adequate" retirement income.

Governments can address retirement income sufficiency in a number of ways including:

- Working to ensure the security and credibility of the pension promise;
- Providing public education;
- Encouraging self-reliance and promoting the importance of saving for retirement, recognizing that the existing social programs are a safety net for Canadians who don't save on their own;
- Developing an environment that allows for the expansion of occupational pension plan coverage through the fundamental principles we noted in Section 1; and
- Some aspect of tax incentives to encourage low income Canadians to save for retirement independently rather than rely on social safety nets.

2e. Is it important to promote expanded pension coverage? If so, should the establishment of or participation in a pension plan be mandatory and, if so, what is the best model? If not mandatory, what could be done to increase coverage?

It is important to promote expanded pension coverage and this should be a mandate of the provincial pension superintendents. Employers should be encouraged, through the creation of incentives and, more importantly, the removal of disincentives, to provide occupational pension plans and facilitate maximum participation. Flexibility is the key – there is no "best" model.

It should not be mandatory for employers to sponsor pension plans for their employees. Increased coverage should instead be promoted through the following changes:

- Private pension plans should be subject to contract law rather than trust law
- Complex pension regulation, particularly of DB plans, should be simplified
- Human resources objectives and innovation, not legislation, should drive plan design

Where plan membership is voluntary, governments can assist in increasing participation through public education, particularly to enhance appreciation of occupational pension plans in the context of overall financial and retirement planning.

2f. What role, if any, should employers play in ensuring sufficient pension coverage and income in retirement?

Social policy should not mandate a role for employers in this regard, but employers who choose to play a role in helping employees to accumulate sufficient income for retirement should not be impeded by pension regulation in doing so. Employers can, and often do choose to provide pension coverage for a variety of reasons, but it is not the role of employers to *ensure* their employees' future income. As discussed above, if disincentives or barriers were removed

employers may have the potential to play a much larger role than they currently do in helping employees to plan for their future retirement.

2g. Some have said that people are demonstrably less successful at preparing financially for retirement if left to their own devices. Is this a problem that governments should be addressing and, if so, to what extent?

Whether or not the statement is true, we believe that governments can promote occupational pension plans and the public's awareness of their inherent value in the context of retirement planning generally.

"Left to their own devices", people may achieve financial security in retirement through prudent personal savings, choosing an employer who sponsors a pension plan for his employees, or embracing a lifestyle which limits discretionary spending. Others may indeed be less successful, ignoring opportunities such as available RRSP room, or employer matching contributions in occupational pension plans.

In some cases, there are factors beyond an individual's control. For example, many parents of the baby boomers have retired in fairly good financial shape, while the generations following the boomers will likely have more difficulty in retiring with sufficient retirement income, due in part to the recognized decline in occupational pension plan coverage as well as post-retirement non pension benefits.

Thus, we suggest a more balanced perspective – we encourage the government to support the establishment, flexible design, and prudent maintenance of occupational pension plans because structured long-term savings plans are an important tool for individuals to utilize in their retirement income planning and savings strategies.

2h. Should governments and/or employers be responsible for the financial literacy of the public and/or employees? If so, how?

In our view, there are roles for governments and employers in the development of a high overall level of financial literacy in Alberta and British Columbia. [1]

Governments can use their policy-making influence over primary and secondary public education to ensure school-aged Albertans and British Columbians are taught the skills required to make good personal financial decisions, including those related to saving and investing over their working lives. Governments can also create public awareness regarding the importance of financial literacy. We note that governments have successfully used awareness campaigns to influence behaviour in areas such as seat belt use, smoking cessation, fitness, and sustainability.

Employers who are plan sponsors already play an important role in contributing to improving financial literacy and we believe they should continue to invest in this area. Employers who do not provide pension plans to their employees are less likely to provide them with financial education. Plan sponsors commonly promote awareness of the pension plan and provide access to information, education, and decision-making tools. They host information seminars covering investing and saving fundamentals; provide access to web sites with calculators and other self

[1] *A study (http://www.cprn.org/doc.cfm?doc=1759&l=en) published by the Canadian Policy Research Network provides, from experiences in other countries, practical suggestions for improving financial literacy in Canada.*

serve financial tools; allow their service providers access to employees in the workplace to promote the use of the various savings plans and tools available; etc. We encourage plan sponsors to continue these efforts. However, we would not be supportive of standards that would impose plan member education requirements to plan sponsors or administrators.

Section 3.0 Pension Standards Legislation – Past, Present and Future

Pension plans represent a component of total compensation. Employers also use pension plans to assist in attracting and retaining employees, and to later transition them out of the workforce into retirement. The employment contract or agreement should govern the obligations of the employer to the employees.

Pension legislation has supported benefits and financial standards and has required disclosure and accountability by employers to plan members and government for regulatory purposes. The emphasis has now shifted toward the financial promise, ensuring that members will receive their benefits. We must now move forward and introduce changes to simplify the implementation and management of pension plans.

We respond first to the four basic questions which the Panel has posed in this section of the Discussion Paper, taking advantage of the opportunity to go back to first principles. We then provide responses to the detailed questions at the end of the section.

What is the pension deal for each type of pension plan?

The pension deal is part of the terms of employment and forms a contract between the employer and employee. It should not be a trust which results in benefits which were never part of the employment contract.

For a DB plan, the pension deal is to pay a pension at retirement. The employer must ensure that there are funds available to pay the promised pension. The pension fund is only a vehicle to assist the employer in meeting the obligation to pay the promised pensions.

In a DC plan, the pension deal is simply for the employer to pay a defined contribution to a financial institution on behalf of the employees. The employees assume all of the risks including investment risk, and longevity risk. What responsibility should an employer have in educating employees in how to make good investment decisions? We believe that if the employer is required to assist the employees, "safe harbour rules" should be established.

In a negotiated cost plan, employers have agreed, through a collective bargaining process, to make specified contributions to a pension fund on behalf of union members for each covered hour of work. Plan members share the investment and other risks associated with the determination of the ultimate benefit. The elected trustees must balance funding, investment and benefit policies for the well being of plan members. Members must understand that benefit levels can change both up and down.

What is promised?

In a DB plan, the ultimate pension benefit is promised, based on a formula, and can be estimated ahead of time.

In a DC plan, the only promise is the regular contributions. The ultimate retirement income cannot be determined with any certainty in advance, and can vary significantly between members with similar work histories but different retirement dates.

In a negotiated cost plan, the promise is limited to the agreed contribution, but both contribution and benefit formulas can change over an employee's working lifetime. Retirement income could be estimated based on a current collective agreement, but it is not strictly defined or guaranteed.

Who pays for it?

Under any plan design, employers and, in some cases, employees and employers, contribute in accordance with the "pension deal" or contract.

Who bears the risk?

In a DB plan, the sponsor bears the investment risk, longevity risk, risk of fluctuating pension costs (accounting standards) and is subject to the varying impact of legislative funding standards on contribution levels from valuation to valuation. Members bear some risk of insolvency, compensation risk (where plan cost may impact the employer's ability to maintain other compensation), and the basic risk of reaching their retirement date.

In a DC plan, employees bear the investment risk and the market-related risk at retirement of insufficient pension income. Plan sponsors bear the risk of being sued by members who may believe that the pension is inadequate as a result of certain action (or lack thereof) by the employer or because of perceived misinformation. Legislation such as the "safe harbour rules" could protect the employer against this risk. In addition, employers bear some indirect risk to the extent that DC accounts can influence employment decisions (e.g. delayed retirement).

3a. Should pension legislation deal not only with the current reality but be flexible enough to deal with future issues and plan designs? If so, how?

We applaud the Panel's undertaking to examine the Alberta and B.C. pension legislation with an eye to deal with current issues plus future issues and plan designs. Current pension legislation does not provide the flexibility needed by plan sponsors to effectively provide a program valued by plan members.

The underlying principles of pension legislation should be clear and flexible enough to allow plan sponsors to deliver the pension promise to plan members in an efficient and cost effective manner, and to accommodate future changes in member behaviour and demographics Under the current system, plan sponsors rely on consultants and actuaries to guide them through complex pension legislation, which is time consuming and expensive, and can frustrate business objectives and strategic corporate planning.

The new regime must accommodate different types of plans, different funding standards, and embrace innovation and simplicity.

The general workforce has come to rely heavily on social programs for their retirement needs. Government should recognize the long run advantage to supporting an expansion of the occupational pension plan pillar (through the removal of disincentives and/or the implementation of incentives) since that will result in less future reliance on the social program safety nets.

3b. What should be the goals of the legislation?

Pension legislation should ensure that plan sponsors adhere to the pension deal. It should support plan members when dealing with delinquent plan sponsors so members do not need to rely on the courts to ensure they receive their benefits. A formal funding policy would provide significant assistance in making the pension deal clear.

Pension legislation should be simple, providing clear principles, clear responsibilities, and be flexible enough for plan sponsors to set up plans that benefit both their employees and their business model.

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.

Plan sponsors are often reluctant to provide new pension arrangements for their employees because of the complexities surrounding administration and regulatory complexity. Plan sponsors currently experience long delays in obtaining regulatory approval of new plans or plan amendments for existing plans. The delays result in added expense for plan sponsors and frustration for plan members.

3c. To what extent should pension legislation be an instrument for social policy or labour market planning (e.g. locking in, phased retirement, socially responsible investing)?

The current government plans (e.g. CPP, OAS, GIS) should continue to address social policy. Minimum standards pension legislation should be flexible enough to accommodate trends in social policy such as phased retirement and socially responsible investing; however, it should be up to individual plan sponsors to determine whether they wish to implement any of these features.

There is now significant inconsistency in Canadian pension legislation regarding the locking-in of pension benefits, and this has become a controversial topic amongst those who work in the pension business. Some practitioners believe that all pension benefits should be locked-in. Others believe that all pension benefits should be unlocked upon a member's separation from the plan sponsor, and others have views somewhere between these extremes. This continues to be an issue of significant discussion within the ACPM, and, although we have not yet developed an official position, we are definitely concerned about the increasing lack of uniformity of locking-in rules across the country.

Governments should encourage but not mandate pension programs. Financial education and retirement financial planning should be provided to Canadians throughout their lifetimes to enhance financial literacy, and clarify the importance of augmenting social programs in retirement. Government programs should address the "base", and employer programs and individual savings should be encouraged but not mandated.

3d. Should the goals of the legislation include promoting expansion of the system in Alberta, British Columbia and throughout Canada? If so, in what way?

Yes, expansion of the pension system, and the resulting benefits, should be a clear goal of legislation in Alberta, British Columbia and throughout Canada. It is well documented that the number of working Canadians with pension coverage has been on a downward slope for some time. Legislation should clearly focus on reversing this trend in the future. Pension coverage has many positive attributes for employers including the ability to attract and retain workers and assisting employees in attaining financial security in retirement. For employees, pension programs provide tax effective savings mechanisms and a measure of self-sufficiency. Perhaps more importantly pension programs support a reduced need for public support mechanisms as employees retire.

The following legislative actions would support this expansion:

- A change from trust law to contract law governing private pension plans
- Simplified legislation targeted at securing the stated pension promise;
- Removing / reducing costly bureaucracy required to administer pension programs;
- Safe harbour rules for DC plans; and
- Uniformity of pension legislation across the jurisdictions.

3e. What approaches to pension standards legislation in other jurisdictions have potential applicability in Alberta and British Columbia?

- Letter of Credit Financing – recently introduced in Alberta as an option for solvency funding, this is a welcome resource for plan sponsors. Likewise, Alberta introduced temporary solvency funding relief for SMEPPs. Similar legislation should be introduced in British Columbia.
- Pension unlocking – recent legislative changes in some provinces (including Alberta) allow some unlocking on employment termination. It would be prudent to have consistent rules for simplified administration.
- Phased retirement programs – Regulators need to remove existing barriers to implementing phased retirement programs allowed under the *Income Tax Act*. Employers should not be restricted in their ability to administer these programs with a focus on business and workforce management needs.
- Single regulatory regime -- similar to the *ERISA* legislation in the United States.
- Safe harbour rules for DC plans – similar to the *ERISA* legislation in the US.
- Alberta and British Columbia should <u>not</u> consider implementing grow-in rights, pension benefit guarantee funds or forced pension committee membership that are in place in other pension jurisdictions. These programs add cost and administrative complexity and do not support pension growth in Canada.

Section 4.0 Broad Pension Policy Issues

4a. How important is harmonization of pension standards between AB and BC?

It is very important for Alberta and B.C. to harmonize their pension standards. We acknowledge the difficulties in attaining an environment of uniform pension regulation across Canada. Harmonization of the legislation across even a few provinces will help reduce the number of different rules from the current unmanageable level.

We recognize and urge action on other needed changes to the legislation, particularly to address decreasing coverage levels and remove existing impediments. We suggest that a focus on harmonization not stand in the way of achieving these other much needed reforms.

4b. Should harmonization of pension standards be addressed more broadly across the country and, if so, how should the harmonization goal be addressed?

Harmonization should be addressed more broadly. We believe that the ideal situation would be a single pension regulatory regime in Canada. We strongly believe that a lack of uniformity continues to burden the pension industry through direct costs, stakeholder frustration and, ultimately, as a factor in decreasing coverage levels.

4c. To what extent should legislators establish principles in the legislation vs. specific rules? How would moving to principles-based legislation change the regulators' role? Should the regulators' role be to enforce specific standards or more broadly to assess whether pension plans are being administered in a safe and sound manner using best practices?

In general, we believe rules-based legislation restricts evolution through innovation. In our experience, regulators are reluctant to permit plan provisions or actions by a plan sponsor that are not explicitly permitted under the rules.

The challenge with principles-based legislation is that the regulators, and to some extent plan sponsors, prefer rules. Rules allow the regulators to operate consistently, thereby enabling them to justify their decisions to all stakeholders. In the absence of rules, plan sponsors are less certain how a regulator may respond to proposed changes.

Consequently, our view is that the legislation should combine principles and rules. We believe the following provisions should be rules-based:

- Eligibility, membership, vesting, locking-in, spouse's benefits, and early retirement. Rules regarding eligibility and membership should be flexible to accommodate the changing nature of employment relationships.
- Certain disclosure requirements, e.g. member annual statements.
- Plan termination issues, in particular the treatment of underfunded plans.

The following provisions should be principles-based:

- Investment requirements (other than the need for rules against self-dealing) would be based on the prudent person principle (i.e., no quantitative limits) and an appropriate Statement of Investment Policy and Goals.

- Surplus and deficit "ownership", clearly defined in plan documents within broadly established minimum funding standards. Surplus entitlement rights must be clarified and plan sponsors must be able to adopt a "fresh start" approach to the new rules.

- Funding requirements, subject to rules-based minimum funding standards. As good governance, plans should have a formal funding policy which is consistent with the pension deal, but this does not remove the need for, or exempt a sponsor from, minimum funding standards.

- Plan administration, based on a formal governance policy developed by the sponsor.

The regulator's role should be to ensure that each plan has established the applicable policies, conducted and documented annual compliance reviews, and has a clear action plan to correct any deficiencies found as a result of the reviews.

4d. Should the governments set standards for good governance? If so, what would those standards consist of? How should they be monitored and enforced?

In general, we support the continued collaborative efforts of regulators and industry to develop best practice guidelines in this area (e.g. CAP and CAPSA guidelines) as opposed to moving to legislated governance standards. Having said this, we would be supportive of governance legislation provided optional compliance provides a "safe harbour" for sponsors.

We expect that such safe harbour legislation would need to be prescriptive, addressing all major elements of good governance. The onus would be on sponsors to ensure their compliance in order to gain the safe harbour benefit.

4e. Various parties participate in the pension system and regulatory resources are costly. Who should pay for the cost of regulating the pension system?

We do not consider the annual regulatory fees paid by registered plans in Alberta and B.C. to be significant. Generally, the greater barrier to coverage is the additional fees paid to professional advisors to help sponsors negotiate complex pension legislation as well as the soft dollar cost of assigning sponsors' internal resources to these issues.

Therefore, we generally would not object to a "user pay" system provided:

- users are paying only for government resources that directly impact the regulation of pension plans in Alberta and B.C.;
- a critical mass of registered plans can be sustained in order to keep costs modest;
- value is being added and demonstrated, and
- significant simplification of the legislation is achieved to minimize bureaucracy.

Section 5.0 Specific Elements of the Standards

Private sector DB plans are an essential element of the Canadian retirement system and finding a balance between the interests of plan sponsors and plan beneficiaries means finding a way to ensure their survival. ACPM believes that the risk/reward asymmetry that currently exists, whereby 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. Consequently, it is imperative that governments introduce some meaningful, permanent solutions to deal with the risk/reward asymmetry. We support legislative changes that recognize that stakeholders who are exposed to downside risk should quite reasonably be entitled to the upside benefits of taking such risk.

A large part of the risk/reward imbalance in the current DB funding model arises from solvency valuations. Solvency valuations have created significant contribution requirements for plan sponsors and led to unnecessary over-funding for the majority of plans. Two practical methods address this issue directly while striking a balance between the interests of sponsors and beneficiaries:

- Letters of credit (LoCs)
- Special purpose "solvency accounts", independent from the pension fund.

Solvency accounts would need to be accommodated through *Income Tax Act* changes; LoCs do not require any federal legislative change.

LoCs 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. The main drawbacks are that they are not available to all plan sponsors for a variety of reasons: corporate structure, plan design (e.g. SMEPPs), lack of credit availability, etc., and they are a direct, and not always insignificant cost to the employer.

The solvency account concept is discussed in response to question 5f below.

5a. Should minimum funding rules continue to address both going concern and solvency liabilities or should the focus be solely on solvency funding?

Both approaches are still necessary in many situations. The going concern valuation is the main measure of a DB plan's financial health on a long term basis, and is used to set the plan sponsor's long-term contribution rate. The solvency valuation is a measure of the security of the benefits under the pension plan.

The going concern concept is consistent with the general accounting principle that requires organizations to report on the basis that they will continue as a going concern entity and is also the approach required by accounting rules to determine the accounting cost of a DB plan, although economic assumptions will differ for funding purposes. The going concern valuation was the only prescribed test for funding purposes until the introduction of the solvency rules in the 1980's.

Under current funding rules, solvency funding is required to cover the future contingency that a plan sponsor of an underfunded plan will go bankrupt and be unable to pay off the deficit. Plan sponsors are required to commit large amounts of capital to cover this unquantifiable event. This additional funding may ultimately not be required or may lead to significant going concern surplus if favourable experience occurs.

5b. *Should the minimum funding rules take into account the financial health of the employer sponsoring a DB plan, and if so, how?*

Yes, the rules should consider the financial health of the DB plan sponsor. We propose that there be a basic rule as there is now (5 years), but that plans could apply for an extension based on the financial health of the plan sponsor. This could be measured through one of the debt rating agencies, not the pension regulator.

We suggest that the amortization period for financially stronger companies be extended to 10 years which is half way between the current solvency and minimum going concern amortization periods. We observe that Alberta has eliminated solvency funding requirements for publicly funded plans.

5c. *Should minimum funding rules take into account the risk profile (asset / liability mismatch and asset mix) of the plan and, if so, how?*

It would be impractical to implement minimum funding rules related to each plan's specific risk profiles. There are many ways to measure risk and no single method could be constructed that would apply fairly to each different plan and its unique situation. Risk measurement is not a simple process. Also, the investment policies of large plans are complex and industry is evolving towards more complex investment structures.

It is unlikely that regulators would have adequate resources to effectively administer funding rules based on the plan's risk profile.

However, if other recommendations in this submission are implemented to allow solvency accounts and letters of credit to address asymmetry and solvency funding issues, then we would support the concept of incorporating reasonable provisions for adverse deviations ("PfADs") in the pension legislation, using a simplified approach.

5d. *Should each DB plan be required to have a funding policy? If so, should it be a regulatory filing requirement?*

ACPM believes that documented funding policies for DB plans should be mandated as a fundamental principle of good plan governance, but without prescriptive rules on the content or administration. Were such policies in place in the past, some of the current difficulties faced by plans today may have been less severe.

5e. *Is "one-size-fits-all" legislation adequate – or should there be different rules for different pension models? If so, how should they vary?*

One-size-fits all legislation is neither adequate nor appropriate. ACPM feels there should be different rules for plans with different risk-sharing arrangements and risk/reward characteristics. For instance, Alberta currently provides publicly funded plans with an exemption from funding on a solvency basis, and specified multi-employer pension plans (SMEPPs) are allowed to temporarily suspend solvency special payments.

In particular, we believe that multi-employer pension plans (MEPPs) in B.C. and Alberta should be treated differently than single-employer plans (SEPs) because, unlike SEPs, members of MEPPS own both the financing risk and reward.

We believe that MEPPs are more like DC pension plans than DB – contributions are usually set at fixed levels through collective bargaining and target benefits established by a Board of Trustees. MEPPs continue to be over-funded on a going concern basis and underfunded on a solvency basis. Unable to meet these minimum solvency funding standards, many MEPPs have been forced to reduce benefits. This also creates intergenerational inequities as contributions that have previously been earmarked for benefit improvements are used to fund the solvency deficiencies.

Solvency rules are a very blunt instrument for dealing with negotiated MEPPs and should be eliminated. The funding issues that solvency tries to address for these plans should be dealt with in a more direct fashion.

Instead of solvency rules for MEPPs, we first encourage government to introduce legislation specifically addressing areas of potential abuse, such as inappropriate benefit improvements. Secondly, the government should require plans to provide increased member disclosure, including confirmation that benefit levels are targets and are not guaranteed. Finally, there should be legislation concerning the treatment of the withdrawal of individual employers from MEPPs. The legislation could be developed by the B.C. and Alberta governments respectively or they can require plans to develop their own guidelines.

To conclude, we think that the whole issue of funding regulations for MEPPs should be reviewed from first principles and solvency funding eliminated for these plans.

5f. Are there compromise solutions to the conflict between risk-reward asymmetry and benefit security in DB plans?

Yes. 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 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 full or partial 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 tax authorities will need to be encouraged to increase the maximum employer contribution funded ratio to at least 120%. 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 could possibly lead to enhanced benefit security for plan members.

Consistent overfunding of a pension plan through the application of the solvency rules is an unproductive use of corporate capital. We believe the solvency account approach provides a compromise. Employers have access to funds in the solvency account under certain conditions and as a result have assurance that they will receive full value for their solvency funding contributions. On the other hand, these proposed changes that provide plan sponsors with additional contribution flexibility should enhance the benefit security for plan members.

5g. How can the conflict between short-term benefit security and long-term contribution predictability for DB plans be best addressed?

Alberta has already come a long way by allowing plan sponsors to fund solvency deficits through letters of credit. We encourage B.C. to follow suit.

Further, our proposed approach using solvency accounts provides a practical compromise. Short-term benefit security is provided through additional solvency funding to the side account. This contingency reserve can be temporary (i.e., employer has access to the funds under certain conditions) and can fluctuate (i.e., reflect actual experience). However, long-term contribution requirements under the plan can be based on the going concern concept which is more predictable than solvency.

5h. What changes, if any, in investment standards are required to allow enough investment flexibility while continuing to protect benefit security?

We recommend holding pension investments to the standard of a prudent person and eliminating all quantitative limits on investing. Canada is the only developed country that uses quantitative limits, instead of the more universally applied prudent person standards for investing. Studies have consistently shown that such restrictions, by limiting the pool of available assets, have a negative impact on pension fund performance.

Capital markets are global – Canadian dollar denominated assets can readily be substituted for any other asset in a global pool of liquidity. A greater opportunity set of investments leads to a higher probability of increased risk-adjusted returns. The greater range of investment options and strategies available, the more diversification can reduce risk, and the greater the opportunity pension funds have to obtain higher returns.

Governments have influenced these strategies in the past by, for example, limiting the foreign content in pension plans. ACPM believes that the industry has evolved to the point that pension funds should be governed by the prudent person rule, which enables pension plan administrators to make the best investment choices for their plan.

While ACPM believes that all quantitative limits should be eliminated, an immediate exemption should be made from two specific rules:

- the 10% issuer rule for U.S. Treasury bonds and bonds of U.S. government agencies, similar to the exemption currently provided for Canadian bonds issued by Canadian government issuers
- the rule restricting a pension plan to electing no more than 30% of the directors of a company, even though it may own more than 30% of the equity.

5i. What specific pension standards could be classed as "irritants", and how should they be changed?

Terminated Plan Members – Individuals with benefit entitlements under a DC plan but without a continuing relationship with the sponsoring employer create expensive ongoing administration and logistical communication difficulties. Administrators should be given the right to force such former employees out of the plan. After specified steps have been taken, pension money owed to any such former members who cannot be located should be transferred to a public trustee. If tax legislation were changed to allow pension plan administrators to establish locked-in RRSPs in the name of former members, this would present an alternative solution. We note that, in some provinces, the

"small pension rules" in DB plans provide the ability for sponsors to force out certain terminated members; however, this is limited, and the small pension limits differ, in some cases significantly, between provinces.

Marriage Breakdown – Although this is outside the pension legislation in B.C., we support the simplification of these provisions and advocate for immediate settlement to be enabled. Pension administrators should be able to charge the full cost of the calculation and communication of the pension split to the affected parties (no different than the parties paying for legal work required in a marital breakdown).

Electronic Communication – The regulators should ensure that electronic communication is seen as a viable alternative for plan sponsors to ensure members are informed.

5j. What changes, if any, should be made to disclosure requirements while ensuring that the interests of plan members and sponsors are balanced?

ACPM believes strongly in transparency (i.e., the risk/reward deal for all pension plans should be clearly defined and communicated to all stakeholders). Written funding policies should be mandated as a fundamental principle of good governance. Key policies related to the governance, investment and funding of a pension plan should be, as a matter of industry best practice, available to all stakeholders.

5k. Should pension legislation establish safe harbour rules that would give DC plan sponsors and administrators protection from liability if they follow certain minimum standards? If so, in what way?

ACPM recommends adopting the concept of a safe harbour for certain design features of retirement savings arrangements that meet criteria prescribed by legislation/regulation. This is consistent with the safe harbour rules under *ERISA* in the United States. Provided that a stakeholder (be it an employer, plan administrator or service provider) complies with a clear set of requirements, the stakeholder should have protection from legal liability in respect of those requirements.

The concept of a "safe harbour" is widely misunderstood. It is not a panacea or a complete release of liability for a person with legal responsibilities in relation to a retirement savings plan. Instead, a "safe harbour" provides legal protection from claims made against a stakeholder in respect of a particular plan design feature if the stakeholder has complied with all of its prescribed obligations under statute or regulation.

We believe that the certainty and protection of a safe harbour will encourage the adoption of retirement savings plans.

Legislative change would provide the most robust safe harbour but, in the absence of such change, inclusion of the safe harbour concept in the CAP Guidelines, perhaps as a result of rule-making powers for regulators, would provide significant comfort to plan sponsors.

5l. Are the current standards in each province's legislation adequate to facilitate phased retirement programs? If not, what changes or additions are needed?

Regulators should ensure that the provincial pension legislation does not impede or restrict the phased retirement initiative, and that it supports the ability for employers to use phased retirement to retain qualified employees for a longer period prior to full retirement. Neither party should be

discouraged from a phased retirement arrangement because of the complexity of the legislation. We observe that where the employer chooses to offer some payment of pension on phased retirement, the administrator must provide a substantial amount of education and explanation.

We believe that employers should not be required to provide special pension arrangements for employees who have taken some kind of phased retirement. Business and workforce management needs should govern the design of a phased retirement program. This should be an employer-initiated program and not an automatic member entitlement.

5m. Are there new plan designs that should be specifically contemplated in the legislation?

The key is that legislation should be flexible enough to accommodate new plan designs as they arise. Other countries and commentators have presented a variety of plan designs and, given time and necessity, new plan design will evolve. Policy needs to encourage a search for new models that can offer Canadians more attractive ways to pool their resources and save for retirement.

Such flexibility would address a current issue - target benefit plans are currently treated as defined benefit plans, but, target benefit plans do not have a surplus or deficit. If the experience is good, the target can be met or increased; if the experience is poor, the target must be reduced. Solvency funding rules should not apply.

Section 6.0 Related Legal Frameworks

6a. To what extent are legal issues beyond provincial jurisdiction creating problems in the pension system and what role, if any, should the provincial governments have in addressing them?

There are two primary sources of legal issues beyond provincial jurisdiction that are creating problems for the pension system:

- The *Income Tax Act* – rules mostly relate to maximum pension standards (provincial pension standards legislation prescribes minimum standards)

- Common law – principally influenced by court decisions interpreting trust and fiduciary law and sometimes pension standards and tax legislation itself.

Among the specific legal issues beyond provincial jurisdiction that should be addressed are the rules in the *Income Tax Act* that limit employer contributions when plans are in surplus. Maximum pension contribution limits are sometimes too low to permit funding buffers to develop. This outcome suggests that the tax rules may be too general and inflexible. ACPM urges the provinces to push for federal changes to increase the maximum funding rules.

Court decisions in all of Canada's provinces effectively create pension common law. This causes uncertainty for both plan sponsors and regulators of pension plans. In addition to creating legal uncertainty, court decisions and the prospect of future court decisions can have counter-productive regulatory results, such as when Monsanto forced the Ontario regulator to review historical partial windup approvals. Adding to the confusion is the fact that most pension cases are products of provincial superior courts, which means that court decisions applicable in one jurisdiction are not necessarily applicable in others. ACPM proposes that provinces enact clear pension standards codes that minimize the potential intervention by common law.

6b. Are there areas in which federal and provincial rules are working at cross-purposes, and how could these conflicts be corrected?

Yes. Funding issues are an important example of this. There needs to be incentive provided by the federal government for employers to put more money into pension funds, while provinces, using the recommended solvency accounts, could make it easier for plan sponsors to get excess funds out.

Insolvency, bankruptcy and creditor protection rules are another awkward area of provincial/federal inconsistency. The legislative ability of provinces to protect registered pension plan holdings from creditors sometimes comes into conflict with federal bankruptcy and insolvency legislation. Provincial regulators and OSFI are sometimes drawn into bankruptcy, insolvency and restructuring proceedings in an attempt to protect plan members' interests in obtaining funding from employers for poorly funded plans. The courts are becoming increasingly involved in this confusing area. ACPM supports the pending federal amendments to the *Bankruptcy and Insolvency Act*, which add some clarity to pension obligations in these situations.

ACPM's position is that any additional obligations on employers who are at financial risk must be considered very carefully. We encourage the provinces to open discussions with the federal government on these issues.

6c. To what extent are other legal issues within provincial jurisdiction creating problems in the pension system, and how could these problems be corrected?

Provinces have the power to harmonize their pension laws with those of other provinces or model pension acts. However, despite some efforts at coordination and harmonization through the Canadian Association of Pension Supervisory Authorities, there has been no strong movement for provinces to harmonize their laws in recent years. An updated reciprocal agreement amongst the provinces would be helpful, as would a model act and a reciprocal recognition of court decisions on pension matters. The Panel should support CAPSA's initiatives in these regards as outlined in their 2008-2010 strategic plan.

However, there needs to be political will and a public demand for harmonization as a virtue, even if it means provinces effectively give up some of their autonomy in the area of pension regulation and oversight. ACPM recommends Alberta and British Columbia enact shared pension standards legislation and common regulatory principles, together with a commitment to renew the reciprocal agreement.

An example of an area where harmonization and codification would be helpful is in plan mergers, carve outs and successor plan rules. No single province has adequately developed the law relating to these areas, yet pensions play an important role in mergers, acquisitions and corporate restructurings. Plan members are frequently and rightly concerned about the status of their pensions when a transaction is unfolding around them, yet the regulatory authorities provide little guidance to plan sponsors and affected plan members. ACPM recommends that pension regulations be reviewed and reformed to facilitate speedy and efficient business transactions through clear rules.

6d. Can and should legislators address the historical interplay between trust law and pension plans? If so, how?

Classic trusts and pension trusts are intrinsically different entities that have evolved from very different origins. Consequently, the application of classic trust principles to pension trusts often results in judicial decisions that, while instructive in relation to traditional trusts, serve to confuse those who must apply the rules to pension plans and pension funds. Generally, this does not result in good policy and acts as a deterrent in the further establishment and expansion of the pension regime.

ACPM believes that the interplay between the traditional principles of trust law and pension plan administration lends uncertainty and lack of clarity to the day-to-day operation and regulation of pension plans. In essence, trust law is ill-suited to the mass membership financial products that are pension plans and it tends to work at cross-purposes with the employer/employee relationship in which such plans are established.

It is the view of ACPM that the B.C. *PBSA* and the Alberta *EPPA* should be amended to similarly oust the application of classic trust law principles in the pension context, particularly in relation to fund holder arrangements. In this regard, such amendments could:

- recognize the applicability of contract law in the creation, operation and regulation of pension plans, on a go-forward basis; or,

- clarify specific areas within the legislation that would limit the need to resort to the application of trust law principles. Such areas could include: the ability to pay reasonable plan expenses from the pension fund; the right to surplus on both an ongoing basis and at

the time the plan is terminated, in whole or in part; or, establish definable rules applicable to plan mergers and asset transfers.

6e. Are there legal problems in the pension system for which it would be appropriate for legislators to intervene and override common law?

The Canadian judiciary currently has little guidance in the area of pension law due to the lack of decisions and harmonized pension rules between jurisdictions. As such, trust law may or may not be applied in the consideration of a pension plan, and even if it is the applied interpretation may not be consistent across the country or with past decisions. The ACPM believes this inconsistency creates a lack of fairness and asymmetry that should be remedied if a level playing field is to be established.

The pension industry has witnessed the development of the common law in a manner that often leads to different legal standards being applied to pension plans at various points in time. This diversity potentially results in a single member's pension being subject to differing legislative regimes throughout the duration of their accrued benefit. The ACPM is of the view that it is time for legislation, and not trust law, to guide the establishment, development and operation of pension plans and related pension funds. The only way to accomplish this is to form a statutory regime within which trust law, and any new pension jurisprudence based thereon, is secondary to the legislative standards, if it is applied at all.

Substantially amending pension legislation is not inconsistent with the principles of legislative reform. It is statutorily necessary in order to equalize the imbalance that numerous judicial decisions have created, and serves to allow pension plan structures to evolve in accordance with the economic environment rather than within the restrictive principles of trust law. Without these amendments the atmosphere of imbalance will continue to discourage employers from establishing or continuing pension plans which, in the long run, is good for neither pension plan members nor the economy.

Notwithstanding the above recommendation to override trust law, the ACPM does not advocate a change in the current fiduciary standard for plan administrators.

6f. What is the best way to deal with legacy issues, such as language in old plan documents, court decisions, and old standards applying to old periods of service?

If the provincial governments accept that the application of trust law no longer serves as a useful tool in the evolution of pension law, then addressing legacy issues must be a considered part of that transition. It is the position of the ACPM that it is necessary to move beyond trust law in relation to pension plans. However, prospective changes cannot be applied to the neglect of the accrued rights of pension plan members, regardless of whether or not those rights are immediately determinable. In that regard, the following are suggested as potential means by which legacy issues may be accounted for:

- allow plan sponsors to discontinue the application of legacy matters for future service, or to replace pension plans with registered arrangements that are not subject to the current regime. Currently, trust law and successor plan rules make this difficult, but with appropriate legislative consideration it would limit, or overrule, the applicability of legacy issues at the date of determination;

- provide for a legislative framework within which plan members may choose to accept, and apply, non-trust rights on a retroactive basis. This concept would be similar to the surplus sharing provisions that are already in place in various jurisdictions, and would

effectively reduce the number of potential litigations that could arise out of the imposition of a new legal framework;

- legislate a pension structure that would apply to new plans and could apply to existing plans with some approval mechanism, e.g. majority member vote (i.e., a trust-like arrangement subject to a specific code) that would offer greater flexibility than current defined benefit trusts, but that would be expressly exempted from the application of trust law; or

- adopt the principles of contract law in a manner similar to the labour law context. In this regard, pension plans would be akin to collective agreements whereby the valid version of the plan would supersede any earlier edition and the rights of members would exist only under the current plan or the plan that existed at the time their rights crystallized (i.e., death, retirement or termination).

Section 7.0 Your Issues

Thank you for the opportunity to raise issues and provide recommendations on other subjects related to the private sector occupational pension system.

Clarify Rules on Wind-Up DB Plan Surplus Entitlement – Legislation should recognize that pensions are fundamentally different from classic trusts, and should be developed to permit plan sponsors to allocate the benefits of assuming risk to the stakeholders taking that risk.

Develop and Deliver Education – If we are to encourage pension coverage and highlight the need for shared financial responsibility between unions, employers, governments and our citizens, it is imperative that a long term and sustainable financial education program be developed and delivered to our citizens. While plan sponsors are committed to communicate plan provisions to their members, those same members must be made aware that just as housing, education and vacations require planning and saving, so does their retirement. Responsible plan sponsors that provide financial education and information will also admit to their frustration in offering a generous benefit and then having to educate employees to understand the benefit.

In both Alberta and B.C., a Career and Life Management course is required for high school completion. However it is too little, too late and attempts to combine financial planning with career planning and sex education! Financial education basics should be designed by professionals as part of the school curriculum, taught early in the school career and increasingly sophisticated material added in subsequent years. Nurturing the education and self-reliance of our citizens, will ensure they will be less likely to look to the public purse for support during retirement.

Encourage and Support Electronic Pension Communication - We believe that electronic communication between pension plan administrators and plan members has the potential to enhance information sharing while reducing costs and support CAPSA's position that electronic communication should not be discouraged by pension regulations, provided that some basic protections are in place.

Advocate for Auto Escalation and Opt Out – We advocate for employment standards legislation to enable plan sponsors to automatically deduct contributions to capital accumulation plans from plan members' pay and to periodically increase contribution amounts in order to assist the plan member to reach the target retirement income. Employees should be able to opt out, but opting out should not be the default.

Periodic Review of Legislation and Regulations – A pre-determined schedule should be established so that legislation and regulation is reviewed on a regular basis and includes all stakeholders.

Exert Influence on Finance Canada to Increase Maximum Pension and RRSP Limits - These limits should be increased by a significant amount and then indexed to wage inflation. Adequate contributions are probably the single most important element in creating an adequate retirement income.