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The Association of Canadian Pension Management

L'Association canadienne des administrateurs de régimes de retraite

Brief To The Ontario Expert Commission on Pensions

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Prepared by the
ACPM Advocacy & Government Relations Committee
Expert Commission Task Force

ACPM COMMISSION DELEGATION

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FOREWORD

1. Introduction

This brief contains comments by the Association of Canadian Pension Management ("ACPM") in response to the February 2007 paper issued by the Ontario Expert Commission on Pensions entitled, "Reviewing Ontario's Pension System: What are the Issues?" The ACPM was very pleased when the Minister of Finance created the Expert Commission and gave it a broad mandate with a particular focus on maintaining and encouraging the system of defined benefit (DB) pension plans in Ontario. We at the ACPM believe that it is possible for the government to create an environment in which DB pension plans can flourish and continue to be an important part of retirement income security for citizens of Ontario. However, we also believe that, to bring this about, technical and administrative changes as well as more fundamental changes of principle and law are necessary. In many ways, the current system of pension regulation in Ontario is strong and, perhaps, one of the best in the world. In other ways it is lopsided and unfair, and discourages plan sponsors from establishing new and funding existing plans beyond the minimum regulatory financing requirements. A greater sense of balance and fairness needs to be brought to the legal and regulatory context of pensions in Ontario. That would be an excellent way for the government to encourage the growth and health of DB pension plans.

2. The Association of Canadian Pension Management (ACPM)

The Association of Canadian Pension Management 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
- Excellence in governance and administration.

The ACPM regularly advocates and participates in public dialogue on pension issues. Notably, in recent years, three significant reports have been produced to further public debate on the retirement income system in Canada. These reports are:

"*A Retirement Income Strategy for Canada: Creating the Best Retirement Income System in the World*" (1997) (see Accompanying Document # 4)

"*Dependence or Self-Reliance: Which way for Canada's Retirement Income System?*" (2000) (see Accompanying Document # 3)

"*Back from the Brink: Securing the Future of Defined Benefit Pension Plans*" (2005) (see Accompanying Document #2)

3. Structure of this Brief

This brief was prepared by the ACPM's Advocacy and Government Relations Committee (AGRC). The AGRC established four sub-committees and divided the issues raised by the Expert Commission into the following four areas, which forms the basic structure of this brief:

1. Coverage Issues
2. Funding Issues
3. Regulatory Protection Issues
4. Other Issues

The need to integrate the work of four volunteer sub-committees in a relatively short period means that the sections of this brief vary in style and approaches to the subject matter. However, what is consistent is that the four sections are each well-reasoned and thoughtful, and address the Expert Commission's questions.

Attached to this brief is a concordance which, to the best of our ability, cross-references the specific questions raised by the Expert Commission to the relevant parts of this brief.

Other ACPM documents relevant to the work of the Expert Commission accompany this brief (see Accompanying Documents).

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EXECUTIVE SUMMARY

In many ways, the current system of pension regulation in Ontario is strong and, perhaps, one of the best in the world. At the same time; however, it also is unbalanced and unfair, and discourages plan sponsors from establishing new plans and from funding existing plans by any means save the minimum regulatory financing requirements.

Changes are long overdue in the pension system in Ontario (and Canada). We believe coverage in defined benefit pension plans should be encouraged, funding issues should be resolved and regulatory clarity should be addressed. In order to effect appropriate changes to the system, the ACPM advocates that the following principles govern any modifications:

1. ***Increased Coverage Levels*** – Incentives are needed to encourage the creation of more plans in order to increase coverage levels. Disincentives for employers setting up or retaining pension plans should be removed or reduced.

2. ***Flexibility*** – An environment must be created where flexibility is a key characteristic that impacts the method of funding, the type of benefit offered and the investment strategy employed. This would be set against a regulatory backdrop that could accommodate different types of plans and evolving plan designs.

3. ***Balanced Environment*** – The environment for employer-sponsored pension plans must be designed to be fair to all parties and ensure that the primary purpose of providing income to beneficiaries is the key focus and that sponsors are not encouraged to fund only at minimum levels.

4. ***Remove Impediments for All Types of Plans*** – Plan sponsors and members (or their representatives) should be able to choose from a wide range of plan designs that are roughly equivalent from a tax treatment or regulatory perspective and determine which best fits their needs. Legislation and regulations must not provide disincentives to the establishment and maintenance of DB pension plans.

5. ***Recognition by the Regulatory System of the need for Different Types of Plans*** – Legislation and regulations governing pension plans should be clear and reflect the risk/reward arrangements between sponsors and members. Pension regulators must not limit the types of pension arrangements available to employers and employees because they don't fit the current structures and rules.

6. ***Clarifying the Role of Regulators and Standard Developing Bodies*** – The pension deal should be struck between sponsors/employers and their members/employees or unions. The role of standards, regulations

and legislation must be to secure the pension deal (versus trying to change the deal or imposing conditions outside that original deal).

7. ***Leadership and Harmonization*** – As Canada's largest pension jurisdiction, Ontario should take the lead in pension policy, but should be sensitive to the need to harmonize pension laws where possible.

8. ***Periodic Adjustment to Legislation and Regulations*** – Pension legislation and regulations must be reviewed on a regular basis to ensure they remain appropriate to any external changes. Such reviews need to include representation from all key stakeholder groups and be governed by a pre-determined schedule.

The ACPM has observed, with dismay, the tendency of legislators to permit the courts to establish pension policy in the absence of clarity in the legislation. In particular, the tendency of the courts to apply trust law principles to pension plans, rather than view them as contractual arrangements between employer and employees, has distorted the original "pension deal".

A thorough review of the Pension Benefits Act is long overdue. The industry has changed fundamentally since the late 1980's and the Pension Benefits Act is in need of revision. We welcome the debate and look forward to sharing our ideas with the Commission on how we can enhance Ontario's retirement system.

We believe that with broad debate, and balanced and fair trade-offs, Ontario can create a legal context that encourages, not discourages, the creation and maintenance of occupational pension plans, to the benefit of all Ontarians and the competitiveness of Ontario industry.

PART ONE: COVERAGE ISSUES

PART ONE: COVERAGE ISSUES

Introduction

Income security in retirement is important from economic, social and workforce perspectives. The Expert Commission Discussion Paper (Discussion Paper) asks for responses to focus on defined benefit plans. The ACPM believes that DB pension plans play a critical role in the Canadian retirement system and changes are required to encourage employers to establish and maintain them. It should be noted however, that many aspects of our brief can be extrapolated to defined contribution (money purchase) arrangements. Our primary focus is improving the overall system with the ultimate goal of improving coverage for working Canadians.

There is much research that shows Canadians are not high savers, and left to their own resources, are not financially prepared for retirement. Studies also show that even when offered optional matching contributions by employers, members of plans often do not make contributions. In addition, there is a huge amount of unused RRSP room available to Canadians.

We believe that coverage under any retirement plan will increase members' interest in their future retirement and assist in the education process, ultimately leading to a more informed public. With education and awareness, Canadians may better appreciate the value of pension plans which in turn may encourage improved benefits or coverage in lieu of other compensation. For employers who compete in a global economy, members' appreciation of the total compensation package is important to the preservation or growth of pension plans.

As the complexity of managing pension plans has increased over time so have the costs of administering these programs, thereby decreasing the funds available to pay benefits, all things being equal. Even the most basic changes to make the pension system more efficient will have a benefit to plan participants.

This paper will highlight the key issues contributing to the decline in occupational pension plans, the most notable being defined benefit pension plans in the private sector. The decline is much less significant in the broader public sector.

Some groups may assert that making coverage mandatory or expanding the CPP/OAS benefits is the most obvious solution. We recognize that mandatory coverage has been successful in other countries. However, the ACPM does not believe that mandatory coverage for Ontario plans is appropriate at this time. Instead, we believe the current system can be enhanced to achieve improvements in coverage. Implementing many of the recommendations that follow will encourage the maintenance of current employment based pension schemes and facilitate the expansion of pension coverage. Only if this incentive-based system does not achieve the social and economic goals should a mandatory system be investigated.

There is a multitude of stakeholders with different perspectives on what has caused the decline of DB pension plans and even more on possible solutions. We have started with nine fundamental principles that we believe are worthy of broad acceptance. If such acceptance is possible, these principles can form the basis for possible solutions. Finding ideal solutions for each stakeholder group is not a practical goal but, given the right leadership and dialogue, making the current system more efficient is achievable.

Principles to Underline Pension Plan Coverage

1. ***Importance of Occupational Pensions*** – Employer sponsored pension plans play an important role in the economic security of plan beneficiaries and of Canadians in general. As such, we believe high rates of coverage are desirable. Many Canadians are financially ill-equipped for retirement, making support from an occupational pension system beneficial. Further, participation in employer sponsored pension plans increases the financial literacy of Canadians.

2. ***Increasing Coverage Levels*** – The current level of private sector coverage in particular is too low. Incentives are needed to encourage the creation of more plans and to increase coverage levels. Disincentives for employers setting up or retaining pension plans should be removed or reduced.

3. ***Encourage Defined Benefit Plans*** – Defined benefit pension plans are an important part of the overall retirement system. However, the current laws and regulations, as well as professional actuarial and accounting standards, create disincentives for the creation or continuation of defined benefit pension plans. Legislation and regulations must encourage the growth of occupational pension plans. Legislators and pension regulators need to balance the objective of protecting benefits accrued to date with the objective of promoting the expansion of pension plan coverage.

4. ***Legislation and Regulations Must Adjust Over Time*** – Pension legislation and regulations must be reviewed on a regular basis to ensure they remain appropriate to any external changes. Such reviews need to include representation from all key stakeholder groups and be governed by a pre-determined schedule.

5. ***Balanced Environment*** – The environment for employer sponsored pension plans must be designed to be fair to all parties and ensure that the primary purpose of providing income to beneficiaries is the key focus. In particular, the current environment discourages over funding of defined benefit pension plans, thereby increasing the cost volatility of these plans making them less attractive.

6. ***Level Playing Field*** – Plan sponsors and members (or representatives) should be able to choose from a wide range of plan designs that best fit

their needs. The pension environment should respect this arrangement and should not unduly change or influence it. For example, DB and DC plans, regardless of their design, should receive similar tax treatment. There are current inequities in the tax system with respect to Pension Adjustments (older vs. younger members, rich public sector plans vs. moderate private sector plans) and with respect to deduction limits for defined benefit vs. defined contribution plans. *(Note: We recognize this is a federal tax issue, but it forms part of the context of pension plan coverage.)*

7. ***Regulatory System Must Recognize Different Types of Plans*** – Legislation and regulations governing pension plans should be clear and reflect the risk/reward deal between sponsors and members. Plans must be regulated and managed based on their risk/reward characteristics. A one-size-fits-all regulatory scheme is inappropriate. The risk/reward deal for all pension plans should be clearly defined and communicated to all stakeholders. For example, the funding policy of a plan where the members own both the financing risk and reward (negotiated MEPP) would be different from a funding policy where the employer owns both the financing risk and reward (single employer plan). Solvency funding may make sense in the latter but not the former. Clear communication of the funding policy is the key to members understanding the risks.

8. ***Role of Regulators and Standard Developing Bodies*** – The pension deal should be struck between sponsors/employers and their members/employees or unions. The role of standards, regulations and legislation must be to secure the pension deal (versus trying to change the deal or imposing conditions outside that original deal).

9. ***Regulatory System Must not Limit Creativity*** – Pension regulators must not limit the types of pension arrangements available to employers and employees because they don't fit the current structures and rules. For example, cash balance plans or lump-sum designs should be allowed if they fit their needs.

Issues to be Resolved

Coverage Has Been Declining

The ACPM is concerned about the level of pension coverage in the Canadian workforce, especially those employed in the private sector. From 1992 to 2003, following the extensive overhaul of the pension and tax law in the late 1980's, DB coverage in Canada declined from 44 per cent of the workforce to 34 per cent (79% for the public sector and 21% for the private sector). The following table illustrates this decline:

Change from 1992 through 2004	
Percentage Decrease in Overall DB Coverage in Canada	25%
- Public sector	14%
- Private sector	28%
Absolute Decrease in DB Coverage in Canada	218,135
	50,040
- Private sector	168,095
Growth in Canada's Total Workforce	2,707,800

While Ontario's level of coverage is slightly higher than national averages, this coverage is concentrated in the province's larger employers and therefore remains a cause for concern. The trend of defined benefit to defined contribution conversions or the cessation of retirement arrangements in general has continued since 2004. More recent statistics will reflect the continued decline of defined benefit plans.

Canada is not alone in experiencing a decline of pension (especially DB) coverage. As shown in the report *Summary of Coverage Statistics for Various Countries* (Attachment 1), DB coverage has declined, often precipitously, in other countries notably the U.S., U.K. and Australia. It should be noted that most European countries have a large proportion of retirement income provided through social security. One further note, DB coverage in the U.K. has continued to decline beyond the 2002 statistics provided in the report.

Conditions of the Current Environment

In the opinion of ACPM, after analysis of statistics and other factors, the following five statements summarize the current environment for pensions in Canada:

1. Coverage under DB pension plans in Canada has been steadily decreasing over time.
2. There is lower coverage in the private sector than in the public sector.
3. The current environment does not support the best interests of plan beneficiaries.
4. There is a lack of clarity of rules and how they are applied.
5. There is a lack of clarity for the roles of the key stakeholders.

The current environment for DB pension plans in Canada is not encouraging. DB pension plans have been, and are, a positive force both in the Canadian economy and in Canada's social fabric. DB pension plans are one of the best ways for a group of people to share and mitigate risk. As a result, members can look forward to the future with a greater level of confidence. At the same time, the Canadian economy benefits by having pools of capital productively invested by professionals in a more efficient manner than would be the case with equivalent amounts made up of individual accounts. Retirement plans (DB and DC) are one of Canada's economic engines. If DB pension plans continue to decline as they have elsewhere, many Canadians may pay a price in view of the burden of risk being transferred to them from their employers. The ACPM believes the DB pension plan system needs urgent attention.

Who Benefits from Coverage?

Overall, the pension environment must recognize that employer sponsored pension plans are voluntary in nature. Plans should be governed and managed with a view to balancing the interests of the plan members with the need to encourage the proper funding and preservation of the pension plan. Pension plan rules must respect the context of the specific arrangement reached between a plan sponsor and its members, and not attempt to impose broader social goals into a program that is governed by an employment relationship.

Canada has a proud history of DB pension plans. While always somewhat limited in their extent outside the public sector, they have had a significant role in the country's overall retirement income system.

1. Employer
   - Attract & retain employees
   - Retire workers with dignity
   - Tax effective contributions
   - Assists with work-force management
2. Members and their families
   - Funded pension plans provide security
   - Contributions are tax deductible
   - Increased financial awareness
3. Government
   - Pension plans foster independence and self-reliance
   - Employer plans reduce pressure to increase social programs
   - Pension plans create capital to fund economic development

Why the Decline?

In the interest of trying to address various risks or issues of member protection, as well as calculation fairness and accuracy, various professions and legislators have created an environment that discourages employers from setting up or maintaining pension plans. These changes have been introduced gradually to address specific issues or to react to specific situations. In aggregate, these changes have been contrary to the primary objectives of why pension plans were originally set up and ultimately are not in the best interests of plan beneficiaries. Many of these changes are contrary to the principles described above which would lead to a healthier pension environment.

We have classified some of the reasons for the decline into the following broad categories:

- Risk and volatility
- Cost and Complexity of Administration
- Workforce Management and Portability.

1. <u>RISK / VOLATILITY</u>

Issue RV-1: Accounting Standards

A key reason for decision makers closing down, freezing, or avoiding DB plans is accounting standards. We agree that the proper recognition of employer liabilities is important and the accounting standards set out to accomplish this goal. However, the long-term nature of pension plans does not neatly fit into an appropriate accounting valuation that is based on calculations that can vary widely from year to year. Plan sponsors of single employer pension plans view this volatility and its impact on the income statement and balance sheet as the key reason to cease offering DB pension plans.

The key concerns of sponsors with the accounting standards include:

- The standard does not operate on a level playing field. The majority of items on corporate financial statements are recorded at historic cost. Some items (e.g., pensions and some financial instruments) are recorded at market or fair value. This has the potential to distort comparisons within financial statements.

- The long-term nature of pension plans does not neatly fit into the current accounting model. Under the current accounting model, short-term market changes often associated with the normal business cycle result in short-term calculations that can vary widely from year to year. While these short-term fluctuations are real, there is a need to separate those costs that are core to offering a plan from those costs that are the direct result of market-based fluctuations (i.e., the interest rate environment and the asset return environment).

These above issues are not adequately or consistently addressed under the current accounting models. As a result, many institutional financial analysts take the information provided in a company's financial statements and make significant adjustments to them in order to reflect what they believe to be the true economic reality associated with providing defined benefit pension plans. Financial analysts agree that the standards should be reformed to better reflect defined benefit pension obligations.

With the recent and coming changes in the Canadian, international and US accounting standards, it appears that the accounting standards will continue to have a large negative impact on coverage in DB pension plans. The retirement system must look towards solutions that work within the accounting standards.

ACPM Recommendation

The above issue primarily affects single employer pension plans where the employer holds all the risk of funding the pension commitments. That is because multi-employer, sectoral or similar arrangements are accounted for using a different model. For these plans, pension expense is equal to the actual contributions remitted and the liabilities are not on the balance sheet of the employer. The reasoning for using a different model is related to the different nature of the promise between the employee and the employer. In a single employer defined benefit plan the promise is to provide a certain benefit to employees and therefore it is also the employer's responsibility to pay for that benefit, while in a multi-employer plan the promise is to provide a certain contribution to employees and it is the responsibility of the trustees to determine what benefit that contribution can provide. Consideration should also be given to managing pension plans as arms-length arrangements with the benefit of having quantifiable exposure for the main operating business.

The pending reform of the US and international accounting standards needs to address several fundamental issues that exist under the current standards.

1. What is the fundamental employer obligation that we are trying to measure?

2. How do we measure this obligation without unfairly biasing the decision of which delivery method is preferable?

3. How do we separate costs between core/operating costs associated with accruing benefits under the regular operation of the plan vs. non-core investment and financing costs related to changes in the economic environment?

4. Are the assets and obligations of these plans part of the employer's balance sheet or are they part of a separate entity?

The ACPM believes that any solution must include the need for the proper stakeholder disclosure of the risk/reward characteristics of the pension arrangement. We recognize that that may be beyond the scope of the Expert Commission's review; however, it helps explain plan sponsor decisions regarding establishing and maintaining pension plans.

Issue RV-2 – Actuarial Standards

There are many plan sponsors and even some actuaries who do not agree with the current Canadian Institute of Actuaries commuted value standards now in place. Plan sponsors cite the following major concerns with the current actuarial standard:

- The standard defines "financial market conditions" as those available in near risk free bond market, whereas pension plans are typically invested in a diversified asset mix that is typically 60% equity, 40% fixed income.

- Combined with the assumption that the member will elect the maximum benefit in value at termination often leads to termination values that exceed their proportional share of going-concern liability, which cost is borne by the plan.

- For pension plans such as MEPPs, members leaving the plan with greater proportional assets than their going concern liability are creating financial losses for the remaining members of the plan.

- Pension plan sponsors typically design pension plans for retirement. Therefore, it seems odd that the standard may reward those leaving a pension plan.

Similarly, solvency standards were implemented in an environment which has now drastically changed.

ACPM Recommendation

The government or regulator must provide the actuarial profession with guidance on the underlying purpose and objectives that constitute social policy decisions. Previous reviews of the actuarial standard have not been sufficient in scope to properly address the underlying purposes of the public policy.

To allow the actuarial profession to establish a commuted value standard that meets public policy requirements, principles underlying the CV rates must be clearly established. Government policy on commuted value transfers should include a broader perspective of all plan stakeholders. After a public policy has been established, the regulators must ensure that the actuarial standards reflect the intent of valuing benefits at termination of plan membership. Our position is that the current actuarial standard does not reflect current public policy. Both the policy and the actuarial standard are in need of review.

The ACPM believes changes to the actuarial standards must engender a view that if the employee chooses a lump sum the rates would be different (less generous) than if the individual has no choice. In addition, legislation (and the standards) must reflect the different types of pension plans and the risk/reward characteristics imbedded in them.

The voluntary election to move pension funds out of a defined benefit arrangement should not be at the expense of the remaining members. Many plans have a shared risk proposition with its members. Most pension plans are based on an historic arrangement or deal between an employer (or multiple employers) and its employees (or members). Practices that change that deal, especially if the application is retroactive, should be subject to broad stakeholder input and agreement.

Without changes, many sponsors will continue to view commuted value standards as another reason why defined benefit pension plans are viewed unfavourably.

Issue RV-3 – Legal and Regulatory

Common law and other legal rulings as well as regulatory changes have created changes to the pension deal between sponsors and the plan members. Uncertainty about the future creates risk that plan sponsors may not be willing to take on. There is little incentive for plan sponsors to fully fund DB pension plans. Too often they are caught in a difficult situation – they are required to fund plan shortfalls, yet are restricted from accessing plan surpluses. The pension promise has been secured, yet excess funds are beyond reach. Changes required to reflect current plan provisions and allow plan sponsors some flexibility in funding DB plans to address today's realities are often overridden by historical plan and trust provisions created in a very different environment. Narrow and rigorous application of trust law principles to pension plans, by regulators and the courts, and the unwillingness of some legislators to address difficult political issues, have created "no win" situations for plan sponsors. In these circumstances, minimal funding strategies are rational responses. Greater volatility of cost and significantly underfunded plans with less benefit security can result – an unwelcome outcome.

In addition, legal and regulatory issues around surplus ownership and use continue to burden DB plans. The 2004 Supreme Court of Canada decision involving Monsanto is a good example of how surplus distribution issues can polarize various interest groups in relation to DB plans. These issues continue to stir emotions and the uncertain legal environment results in sponsors of voluntary DB plans adopting minimal funding strategies or deciding to discontinue existing DB plans. The ACPM has also long been concerned with what it perceives as unfairness and as legislative inertia in the area of pensions. Other organizations have also recognized the need for reform. In recent times, analyses and recommendations have been made by, among others: the Canadian Institute of Actuaries, Towers Perrin, Watson Wyatt Worldwide, Canadian Steelworkers, the Canadian Labour Congress, and the Conference Board of Canada/Watson Wyatt Worldwide survey of CFOs.

ACPM Recommendation

Potential solutions to this issue are covered in greater detail later in this brief.

Issue RV-4 – Risk/Reward Balance

This issue is core to finding solutions to the decline in coverage for DB plans. Legislators and policy makers must recognize the differences in how various risks are shared between the sponsors and the plan members (investment risk, mortality risk, governance risks, funding risk and plan termination risk.). The 2007 Survey on Pension Risk by the Conference Board of Canada and Watson Wyatt Worldwide highlights concerns about this issue among plan sponsors. It has also been recognized as a serious issue by David Dodge, Governor of the Bank of Canada, as reported by J. Thorpe in *National Post* on October 8, 2004 (p. FP4). "Resolving the issue of asymmetry would not only lead to better long-term funding of DB plans, but also would improve the environment for, and facilitate the establishment of, new DB plans."

The ACPM defines "asymmetry" as lack of balance and fairness in the DB system, reflected the mismatch between funding "risk" and "reward" in a DB pension plan. It refers to the fact that a plan sponsor (whether a single or joint sponsor) is ultimately responsible for funding pension benefits including funding shortfalls; but is prevented from access any surplus in the plan, other than for benefit improvements (including mandatory distribution of surplus on partial plan wind-up) or contribution holidays. Asymmetry is a key issue related to the funding of most DB plans. It is most acute for the typical single-sponsor corporate plan. The ACPM believes that resolving the issue of asymmetry would improve the environment for, and facilitate the establishment of, new, properly funded DB plans. Conversely, a lack of action will worsen the situation. Further, other potential changes to the rules of funding for DB plans, changes that would directly benefit plan members, could gain greater acceptance by sponsors in the context of more symmetry in the DB system. Asymmetry is an impediment to the establishment and maintenance of DB plans.

The current situation has resulted from the interaction of many circumstances, including:

- the growth of DB plan surpluses during the 1990's and disputes around ownership

- the reluctance of legislators to directly address the issue of surplus ownership

- the tendency of courts to interpret the pension "deal" as a classic trust rather than as a contract or business trust, and

- standard plan wording imposed by the tax regulator in the distant past (as regards irrevocability of assets) which did not reflect the DB "pension promise."

The root causes of asymmetry are largely legal in nature. In Canada, the asymmetry issue is best illustrated by a series of court decisions beginning with the Supreme Court of Canada's (SCC) 1994 decision in *Schmidt* v. *Air Products* concerning legal ownership of surplus. In *Schmidt*, the SCC held that pension plans funded through trusts are "classic" or true trusts and are subject to all applicable "classic" trust principles.

The Canadian courts have since extended the reasoning in *Schmidt* beyond the surplus ownership issue to such issues as pension plan terminations (*Buschau* v. *Rogers Cablesystems*), pension plan expenses (*Markle* v. *City of Toronto*) and pension plan mergers (*Transamerica*). Classic trust principles, however, do not translate neatly into the pension context. They were developed in the context of testamentary estates (wills) where the trust product was left by a settlor who was deceased. The trust was "fixed" and, except for gains or losses realized through investment, it did not change over time. All of the beneficiaries were entitled to a specific benefit – whether that is a specific portion or part of the trust or the residue of the trust after all of the specific benefits had been provided. The beneficiaries were typically set at the time the trust was created and could not be changed by the settlor from time to time. Pension trusts are fundamentally different from classic trusts in a number of ways. A classic trust is a form of gift involving the transfer of property to a trustee for the benefit of one or more beneficiaries.

A pension trust, on the other hand, is primarily a funding vehicle to provide security for future pension obligations. A pension trust is fluid in nature – new beneficiaries join the pension plan and current beneficiaries leave on a regular basis – and are closely intertwined with employment. Unlike a classic trust situation, the trustee of a pension fund typically has very little discretion in the investment or administration of the trust fund; rather, investments and payment of benefits are performed at the direction of the plan administrator or investment managers. The result of applying traditional trust law principles to pension plans has been, in a word, unsatisfactory. Allowing a series of archaic rules not designed with pension plans in mind to take precedence over contractual arrangements between employers and employees adds an unnecessary complexity and uncertainty into what is intended to be a contractual (employment) relationship, capable of being changed from time to time. It also means that the DB pension promise is being overridden by extraneous factors.

As with other compensation, and pursuant to the intent of parties that negotiate pension plans, this report proposes that pension matters should be viewed more in the context of "contract" rather than "trust." This does not mean a weakening of the laws protecting pension funds which are held to secure pension promises from creditors of the sponsor or the members. Far from it. The rules and laws for these protections should remain and could even be strengthened. It does mean that, for whatever reason, should excess funding arise, the plan sponsor, if it is the party at risk for plan funding, should not be unduly constrained from accessing this surplus. As a result, the sponsor should be free to manage the funding of the pension plan in a more rational way and, along with employee plan members, should have an ability to refresh the pension "deal" as circumstances warrant.

In identifying these issues, the ACPM is not suggesting that the Canadian courts do not recognize the complexities inherent in applying classic trust principles to pension trusts. Many courts have questioned whether "classic" trust principles are compatible with pension trusts. However, as long as the courts feel that they are bound by the reasoning in *Schmidt* (subject to the more recent comments by the SCC in *Buschau*), they will be constrained by "classic" trust principles (or their interpretation of how "classic' trust principles ought to be applied). Accordingly, the asymmetry conundrum should be addressed by the legislatures, not the courts. Only in this way can a reasonable solution be found. Some regulators have taken minor steps to alleviate this problem by permitting agreements to be made for the use of surplus (between the sponsor and plan members) that override trust document wording and they are to be lauded for this. Even so, results are limited and do not address the underlying asymmetry issue. A solution must be found which reasonably enables the parties to a pension plan to refresh or redefine their relationship, in a manner that is not so constrained. The ACPM believes that governments should pass legislation overriding common law trust precedents and make contract law paramount for pension plans.

ACPM Recommendation

The ACPM's views are not unique. Indeed, the British Columbia Law Institute's Committee on the Modernization of the Trustee Act suggested at page 7 of its October 2004 report, *A Modern Trustee Act for British Columbia*, that: "[i]t is appropriate for separate pension legislation to prevail over the Trustee Act where pension funds are concerned." The ACPM believes that the government should pass legislation overriding common law trust precedents and make contract law paramount for pension plans. The ACPM also believes that the government should amend pension legislation to provide that surplus distribution is not required on a partial plan wind-up (i.e., to address the so-called "*Monsanto* issue"). Alternatively, if it is not feasible to override common law trust precedents, or otherwise exempt pension plans from the application of such trust laws, alternative solutions could be considered. These are addressed later in this paper.

The primary solution is pension legislation treating the various risk/reward arrangements appropriately. All parties should be treated fairly according to the risks they face and the risks that are appropriate need to be clearly identified. Professions and governments must recognize that all plans are not alike and make appropriate adjustments to recognize the different types of arrangements. For example, should all sponsors be treated the same for wind-up risks? We believe that the costs of providing wind-up funding should be married to the relative risk and funded position as well as by who owns the risk. Fiduciaries/administrators and plan sponsors should have the appropriate tools and flexibility to manage the pension plan risks.

2. <u>COST AND COMPLEXITY OF ADMINISTRATION</u>

A fundamental goal of any pension arrangement should be to direct as much of the contributions as possible to the plan funding or beneficiaries. The increasing complexity of administration raises the costs of plans and takes away from the pool of funds available for the benefits of their members. The increase in complexity has not been to the overall benefit of the members. In fact, sometimes the reasons for changes are inexplicable to plan sponsors and participants and appear to serve no useful purpose. Areas that have increased in complexity/cost include:

- Legal and regulatory – both in detail and ambiguity
- Trustees requirements and related premiums to cover off these risks
- Administration (marriage breakdown, systems, etc.) – both through complexity and ambiguity
- Communications
- Lack of harmonization
- Actuarial

ACPM Recommendation

Legislators and policy makers must work with the stakeholders to make the pension system more efficient. Simplification without sacrificing the key principles of why pension plans are in place is an attainable goal, with a good return on investment for pension plans and their members.

3. <u>WORKFORCE MANAGEMENT AND PORTABILITY</u>

Issue WM&P-1 – Transfer of Pension Benefits

The workplace environment is often fluid. Mergers, acquisitions and divestments occur, and will continue to be a fact of life. In Ontario, however, pension legislation makes it difficult, if not next to impossible, for groups of affected employees to transfer their pension entitlements from one employer to another. In a divestment situation, rules require absolute replication of benefits, in all respects, and require that all affected plan members be transferred. Under this interpretation, usually no benefits are transferred. As a result, no one really benefits. Plan administrators may face complex administrative and extraordinary costs, while plan members may "win or lose," depending on circumstances. Many members in such situations often see that the sum of their pensions from two or more plans is less than it would have been under the plan of their new employer had they been permitted to transfer in their pension service. These roadblocks have been created by a myriad of tax rules, misguided regulatory interpretation or fear, and court decisions *(Transamerica)*.

ACPM Recommendation

Regulations governing these situations seem to attempt to protect pension plan members from themselves. Further, they are inconsistent. If a member voluntarily terminates employment, the member may freely transfer his or her pension credits or value to a new employer. Why are divested or merged members treated differently? Changes are needed to introduce greater flexibility. The focus should be on proper disclosure and informed choice. It should also be noted that this is a major advantage of multi-employer/multi-sector plans. Perhaps thought should be given to encouraging and facilitating the establishment of more of these types of plans.

Issue WM&P-2 – Harmonization of Rules

A serious impediment to the establishment of defined benefit pension plans in Canada for companies with multiple locations across Canada is the lack of consistency or harmonization of pension laws and regulations among the provincial jurisdictions. Differences abound, many of them trivial. Harmonization is a topic that has been discussed at length for more than a decade. However no real action has been taken and provincial laws and regulations continue to diverge. This creates complexity and expense for plan sponsors, very often for no obvious benefit. Lack of harmonization is not an issue only for multi-jurisdictional plans. It creates additional cost and complexity for service providers (such as trustees, insurance companies, actuaries, lawyers and investment managers), the costs of which are often passed on to plan sponsors and plans.

ACPM Recommendation

Greater effort must be made to harmonize pension laws and regulations across Canada. At the very least, any differences should be justifiable and have obvious benefits. A single national pension law and regulator would be an ideal solution. Even if one pension law in Canada is not possible, as it is in the U.S., then at least having one regulator would help to eliminate inconsistencies in administrative matters.

This issue is addressed further in Part Four of this brief, and in Accompanying Document # 5.

Specific Responses to Further Questions Raised in the Expert Commission Discussion Paper

1.4 – Why has coverage by defined benefit plans decreased? Why are few, if any, new defined benefit plans being established?

Each sponsor of a pension plan may have various reasons for terminating a pension plan or avoiding setting up a new pension plan. In our opinion, based both on anecdotal and survey information, the main issues that are repeated by plan sponsors include:

- Imbalance of risk/reward
- The uncertain cost of DB pension plans and the lack of vehicles available to manage this cost
- Regulatory environment complexity and lack of harmonization
- Standards that are not in the best interest of pension plans and their objectives, which are long term in nature
- Accounting standards developed for investors
- Actuarial standards are biased in favour of members leaving the plans
- Regulations create disincentives for fully funding plans
- Regulators take a narrow view of asset transfers and protection of benefits

- Inconsistent legal rulings and interpretations that do not protect the long-term interests of the pension plan and its members, and the reliance on historic provisions which are from a different era and rely blindly on areas of trust law not appropriate for pension plans.
- Complexity or lack of clarity in regulations (e.g. marriage breakdown)
- Governance risk

Note from the 2007 Survey on Pension Risk (Conference Board of Canada and Watson Wyatt Worldwide) revealed that decision makers prefer DB plans but see the following threats:

- Cost of maintaining (administration) and funding
- Imbalance between funding risk and reward
- Increasing legal risks.
- Volatility of pension expense
- Level of pension expense
- Solvency funding challenges
- Compliance with accounting rules

1.7 – Should different kinds of workers, employers and plans be subject to different regimes of regulation?

Historically the ACPM has advocated consistent rules and regulations for registered pension plans, where appropriate. This means that we acknowledge that there may be circumstances that support different rules for different groups or plans. These need to be carefully studied and debated before being introduced, and perhaps there will be a need for counterbalancing rules also to be introduced. One area of debate, for example, has been the application of solvency rules to labour MEPP's and to public sector pension plans. There are strong arguments to exempt these sectors from traditional solvency tests (as the Ontario government has recognized with the new rules for Specified Ontario Multi-Employer Pension Plans) . The ACPM supports the government's efforts to address these issues, if only temporarily, and urges the government to make the improvements permanent. Any change that reflects the risk/reward differences between types of plans provides some hope to plan sponsors that pension rules may finally evolve. Further changes to reflect the realities of different plans and how best to serve their members are long overdue and are much needed.

We encourage the legislators and regulators to participate in evaluating the appropriateness of rules for different types of pension plans and create longer term solutions so that plan sponsors can better manage their plans. A starting point for this debate would be to clearly define and understand plan differences. The law needs to recognize and more clearly define different types of plans by their risk/reward characteristics. Examples should at least include:

- Single employer pension plans – employer risk (potentially further split by contributory and non-contributory)
- Multi-employer pension plans – employee risk/reward (e.g. labour MEPPs)
- Multi-employer pension plans – joint contributions (e.g. Teachers, OMERS)
- Multi-unit pension plans

3.1 – What role are occupational pension plans, especially defined benefit plans, likely to play in the array of strategies which will provide economic security for future generations of older Ontarians?

Defined benefit plans do have the advantage of spreading individual mortality risk and investment risk by pooling capital that can be managed by professionals at a reasonable investment expense level (when compared to individual Ontarians). For members, DB plans provide a guaranteed and predictable level of pensions, with the plan sponsor bearing much of the risk.

There is much research conducted every year that show Canadians are not high savers and left to their own resources are not financially prepared for retirement. In fact, studies also show that even when offered optional matching contributions by employers, members of plans do not make contributions. In addition, there is a huge amount of unused RRSP room available to Canadians.

Any occupational plan has the obvious advantage of putting away funds for the longer term (individual and economic value) but also increases the awareness and importance of methodically saving for retirement. Participation in pension plans, in general, increases people's awareness of financial issues and planning that they might not otherwise be exposed to (or might be exposed later in their life when it may be too late to adjust).

Occupational plans also reduce the reliance on government.

3.4 – What degree of latitude or encouragement should Ontario pension law and policy provide for plans other than conventional single-employer plans? Should it actively encourage the formation of larger, more sophisticated sectoral, multi-employer, jointly sponsored or cooperative plans? Should other experimental designs be accommodated under the Pension Benefits Act and, if so, subject to what conditions and controls?

First, we firmly believe that the fundamental differences between plans with different risk/reward characteristics should be recognized by different regulations, legislation and policies. Ontario pension law should provide rules that make sense depending on the risk/reward characteristics. When one model may provide economic and social benefits to Ontarians, these could also be recognized.

The formation of larger, more sophisticated multi-employer, jointly sponsored or cooperative plans would have many advantages that should be considered and potentially encouraged:

- Economies of scale.
- Focus on the beneficiaries with less conflict with corporate goals.
- Improved mobility of the workforce.
- Pooling capital will improve net investment returns and reduce risk.
- Risk/reward is clearly defined.
- Simplicity for members and employers. Employers would no longer need to compete on pension benefits if all their competitors participated in the same plan. This makes it easier for employees to differentiate potential employers on issues that they can more readily evaluate (salary, vacation time, etc.).
- For employers, pension expense equals contributions. This may allow more money to be focused on the original goal – the economic security of the members.
- Pension assets and liabilities would not be part of an employer's balance sheet – reduce risk of volatile impacts to business goals while their employees/members still receive the key benefits of a defined benefit pension plan.
- Lower risk of wind-up unless entire industry (or related) ceased to operate. Less impact on pensions if any one employer went bankrupt.
- With clear benefit and funding policies it is easier for members to understand the risks and rewards and feel secure in that their retirement future (perhaps 30 or more years) is not tied to the success of one organization.
- Members could also have a single benefit under a MEPP (or similar) (versus many pieces from multiple employers) which would communicated in a single pension plan statement. This would simplify retirement planning.
- Properly managed MEPPs by definition should not experience a wind-up. Even a well managed stable single employer plan has part of the funding

for current SEPP is directed to the PBGF. These funds could be better used by the beneficiaries of the plan in the form of improved funding levels or better benefits (rather than the PBGF insurance premiums which are not likely to be utilized by these members).

However, similar to government programs requiring employee contributions or supported by taxation, these plans can have intergenerational equity issues. These types of plans should have strict governance models to ensure they are properly managed as designed for the sole benefit of the beneficiaries. These plans should also require completely transparent communication and require filing and the disclosure of benefit and funding policies to ensure that stakeholders are fully aware of how the plan is to be managed.

When considering what sort of benefits could be provided by such larger, broader plans, Canada has, at present, at least two multi-employer models. The most common is the labour MEPP, which is a jointly trusteed quasi-defined benefit arrangement. Employer contributions are fixed and member benefits are defined but variable, if the plan is over or under funded. The second model is mostly found in the public sector, often as a jointly sponsored, shared risk/reward arrangement. In these plans benefits are defined and contributions are variable, and may involve variability for both employer and member contributions. Other models exist, most notably in the Netherlands where there are industry-wide plans. Which model would be best for Ontario? The answer to this question needs further analysis. Would employers embrace these new models? Possibly yes, if they were not burdened by excessive cost and complexity.

Finally, the ACPM encourages changes to the *Pension Benefits Act* (PBA) that would accommodate other innovative designs. Quebec's Member-Sponsored Pension Plan is a good example, in addition to the multi-employer examples above. In an environment of expanding pension coverage, other innovative designs may emerge. To accommodate such changes the PBA needs to be reviewed more frequently than once in 20 years.

4.4 – To what extent should public policy promote and protect defined benefit plans because of their attractions? To what extent can changes in public policy and legislation reduce or eliminate the perceived shortcomings of defined benefit DB plans to encourage wider adoption?

The current laws and regulations, and professional standards, create disincentives to continue or set up a new defined benefit pension plans. At a minimum, these disincentives outlined in our response to question 1.4 should be removed or limited.

We believe it is essential that Ontario's pension legislation re-introduce a mandate promoting the establishment, extension and improvement of pension plans. This is the case elsewhere in Canada and was the case in Ontario until a few years ago. We urge the Expert Commission to consider the mandates of pension regulators in Nova Scotia, Quebec, Manitoba and British Columbia:

- **Nova Scotia, PBA, "Duties of the Superintendent," 10(a)**: "The Superintendent shall promote the establishment, extension, and improvement of pension plans throughout the province."

- **Quebec, Supplemental Pension Plans Act, Chapter XVI, 245** "The Régie also has the duty to encourage financial planning for retirement, in particular by promoting the establishment and improvement of pension plans."

- **Manitoba, PBA, "Duties and Functions of the Commission," section 10(1)**: "The commission shall actively promote the establishment, extension and improvement of pension plans throughout Manitoba."

- **British Columbia, PBSA**, **Section 3(5)b**: "The purposes of the [Pension Benefits Standards] Advisory Council are…to promote awareness of pensions and retirement income planning among employers and employees."

Including such a mandate would serve to strengthen the voluntary pillar of Canada's retirement income system, to the advantage of both employees and employers. We recommend that the government amend the PBA to include such a mandate, and actively fulfil and support this mandate, either through FSCO or another body.

4.6 – To what extent should public policy encourage experiments with new varieties of occupational pension plans (such as cash balance plans that are widely used in other countries) or with alternative types of income security plans designed to deliver retirement benefits to workers comparable to those provided by conventional defined benefit plans?

As outlined under question 3.4, there should not be any artificial impediments to employers and employees choosing pension programs that work best for them.

The ACPM encourages changes to the PBA that would accommodate other innovative designs. Pension legislation should be expanded to include as many options as possible where advantages are maximized and its disadvantages are minimized.

Section 3.4 discusses some suggestions and ideas for multiple employer and sectoral plans that could be helpful in allowing employers to reasonably provide DB benefits to their employees. Other single employer plan designs should also be considered including cash balance plans, pension equity plans and other such lump sum plan designs that are allowable in other countries including the US and the UK.

The ACPM encourages research in developing new and improved DB schemes that meet the evolving nature of the retirement system in Canada. The ACPM strongly suggests that the government, as an adjunct to or immediately following the release of the Expert Commission report, strike an industry advisory group assigned with the responsibility of recommending alternative plan designs and a framework for permitting future creativity. This group could consult with the Canada Revenue Agency and the federal Department of Finance or, better still, have participation from members of those bodies.

In our view, one of the key terms of reference of the industry advisory group should be that there should be no bias in terms of risk, benefit and legislated administrative requirements between plan design options, whether they be primarily DB or DC in nature. The objective should be for the plan sponsor and other stakeholders to choose a design that best meets the needs of the sponsor-member “deal”.

PART TWO: FUNDING ISSUES

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Introduction

This section of the ACPM brief examines funding issues. The section itself is not, perhaps, as extensive as others, or necessarily as specific in its response to the Expert Commission's questions as other sections of this brief. The reason for this is that, in August 2005, the ACPM produced a document that set out in a comprehensive way its position on the funding of defined benefit pension plans. This document is entitled *"Back from the Brink: Securing the Future of Defined Benefit Pension Plans"*. It is attached to this brief (Accompanying Document # 2). We encourage the Expert Commission to read and analyze it, and to assess the document's specific recommendations in the context of the whole document.

The balance of this section will provide an overview and introduction to the larger documents; as well as some other specific comments.

Background

Two objectives set out in the mandate of the Expert Commission are promoting DB pensions in Ontario and safeguarding the security of those benefits. We believe that these can be, inadvertently, competing objectives in the current regulatory environment. Current legislation requires plan sponsors to fund any deficits that emerge over short periods of time, which enhances benefit security. If those contributions eventually prove not to be necessary because of good plan experience, the plan sponsor effectively cannot withdraw any excess funds (beyond, perhaps, a contribution holiday) and also potentially loses control over that money in any number of events, including partial or complete wind-up of the pension plan, plan merger, and plan amendment. This situation has had the following effects:

- sponsors of pension plans are encouraged to make only minimum statutory contributions to those plans, limiting benefit security; and
- very few companies establish new DB pension plans.

Change is required in order to reconcile these twin, important objectives. As stated in the ACPM paper, "Back from the Brink.. ", the system needs to be made better so that:

- all parties are treated fairly according to the risks they face;
- sponsors have the appropriate tools and flexibility to manage pension plan contributions;
- fiduciaries/administrators have the appropriate tools and flexibility to manage the pension plan risks;

- there is transparency for stakeholders; and
- there is a high probability of benefit security.

Key Principles

The overarching objective of our recommendations is to provide more flexibility in the operation of DB pension plans while not jeopardizing the benefit security of plan members. Our recommendations are based on the following key principles.

1. ***Funding flexibility.*** The regulatory environment should be changed to encourage plan sponsors to fund their pension arrangements at levels beyond statutory minima. This needs to be achieved by addressing sponsor concerns about "stranded" cash in pension plans while preserving the security of plan members' benefits.

2. ***Benefit flexibility.*** Pension law should regulate minimum pension benefit requirements. The focus of the law should be on defining bare minimums, not desired benefits. The actual design of benefits should be left to the parties to the pension arrangement which is part of the overall employment contract.

3. ***Investment flexibility.*** Developments in the capital markets happen rapidly. Many of these new vehicles are appropriate for use in pension funds. While plan administrators need to exhibit prudence in establishing the investment policy for the plan, they need to have the flexibility to use appropriate capital market vehicles.

4. ***Flexible regulatory environment.*** A thriving pension world constantly changes as participants modify arrangements to meet changing needs. Pension regulation needs to accommodate this process of evolution.

ACPM Recommendations

Back from the Brink describes the ACPM's view of answers to many of the questions raised in Sections 5 and 6 of the Discussion Paper. We would like to highlight some of the points addressed there, in particular, the point that risk-bearers in pension plan financing need greater flexibility in the funding of those plans. Without this additional flexibility, plan sponsors will continue to fund existing plans at minimum levels and will not establish new plans.

1. <u>Letters of Credit and Solvency Accounts</u>

The ACPM encourages the Expert Commission to consider both Letter of Credit Financing and the concept of Solvency Accounts as means to enhance pension plan solvency funding flexibility and fairness, without jeopardizing benefit security.

Several proposals have been made for Letter of Credit Financing, including the one in Attachment I to *Back from the Brink*. In addition, other jurisdictions have embraced it – federal, Alberta, Quebec. The proposal in *Back from the Brink* predated the regulatory changes. In the interest of harmonization of pension legislation, the ACPM is not wedded to the details of our initial proposal. Instead, the objective of harmony should override. We believe that Letter of Credit Financing would be an effective addition to a plan sponsor's funding toolkit.

The Solvency Account is a concept that was also raised in *Back from the Brink*, but many of the administrative and structural details would need to be worked out in a broader public debate. Under this concept, excess contributions, as required by a solvency valuation, could be made to a Solvency Account. The Solvency Account would be a separate trust from the basic pension plan trust, yet would be an asset of the pension plan trust, if needed (e.g. in the event of a plan wind-up). However, the Solvency Account, by virtue of express statutory rules, would not be subject to the classic trust rules that might apply to the basic pension plan. Subject to any regulations regarding funding sufficiency or over-sufficiency, a plan sponsor would be able to withdraw or otherwise reallocate excess amounts in the Solvency Account that are not required to protect the solvency position of the plan. Solvency Accounts would help plan sponsors manage the volatility inherent in solvency valuations; would not unfairly entrap the sponsor's capital; would not discourage plan sponsors from generously funding their pension plans beyond statutory minimums; and would remove one discouragement from establishing new DB plans. Additionally, Solvency Accounts would in no way jeopardize the benefit security of plan member benefits.

2. <u>Trust Law Lack of Clarity</u>

The ACPM believes that, consistent with recent case law developments that have recognized the differences in pension trusts and traditional common law trusts (e.g. the Supreme Court of Canada's 2006 decision in *Buschau* v. *Rogers Cablesystems*), the Ontario government should pass clarifying legislation recognizing that pension trusts are subject to a specific statute and should not be treated as common law trusts in all respects. To be clear, the ACPM submits that while pension trusts should enjoy the same (protected) legal status as traditional trusts for bankruptcy/insolvency purposes, legislative amendments should make it clear that pension trusts would not be subject to common law trust principles where it comes to matters specifically addressed in the governing legislation (e.g. plan mergers, plan conversions and charging expenses to the pension fund) or in labour contracts. A necessary requirement for this to happen is that the Pension Benefits Act would need to be expanded to specify the requirements for plan mergers, plan conversion, and the charging of expenses to the pension fund.

3. <u>Inflation Protection</u>

Aligned with the concept of flexibility is the ACPM's view of indexation of pension benefits as raised in question 4.5 of the Discussion Paper. Our view is that inflation protection should be left to the discretion of the sponsor (subject to collective bargaining, as appropriate). Sponsors and collective bargaining agents need the flexibility to define appropriate employment arrangements.

4. <u>Consistent Rules for All?</u>

Question 5.5 of the Discussion Paper asks whether different kinds of plans or employers should be subject to different rules. The ACPM believes that there is a fundamental distinction between differentiating among plans, as opposed to differentiating among employers. The ACPM view is that it is entirely appropriate to have different rules for different risk sharing arrangements, such as the recent changes to the funding requirements for Specified Ontario Multi-Employer Pension Plans, which we support. On the other hand, care needs to be taken when differentiating among different employers who sponsor plans with the same type of risk sharing. The "jumbo plan" rules, as applied to Stelco, are an unsuccessful example of the latter.

Some have argued that plans sponsored by government should not be subject to solvency funding requirements on the rationale that government will not "go out of business". While the ACPM does not take a view on the merits of this, it does urge the Commission to consider two issues in coming to its recommendation:

- While the government may not go out of business, ongoing changes in the economy may cause a material restructuring such that the covered group for any particular plan may either cease to exist or reduce dramatically.

- Even if government and the covered group do not go out of business, there is some merit in having those responsible for pension regulation subject to the same rules as the private sector in order to have a better understanding of the issues they face.

5. <u>Funding Issues on Plan Wind-Up</u>

The regulatory aspects of partial wind-ups are addressed in detail in the following section of this submission. In that section, we recommend that surplus existing in a plan on partial wind-up should not have to be distributed and that the concept of partial wind-up should be removed from the PBA on a prospective basis.

There are also funding issues relating to wind-ups. Current practice requires annuities to be purchased for those participants affected by a full or partial wind-up who elect to receive lifetime income from the plan. While the ACPM is of the view that the concept of partial wind-up should be removed from the PBA, if the concept continues, the requirement to purchase annuities should be eliminated. The ACPM sees no reason why different treatment should be afforded to those who retire as a result of a partial wind-up relative to those who retire in other circumstances.

There is also a practical deficiency in the PBA in the event of a full plan wind-up or a large partial wind-up. The Act contemplates annuity purchase for all remaining life income obligations. However, the annuity market in Canada is relatively small (reportedly roughly $1 billion of annuity purchase in a year) and there is no effective market for indexed annuities. There are a number of plans registered in Ontario that, upon wind-up, would by themselves absorb more than the total Canadian capacity in one year. Depending on the market circumstances, this could produce either a very uncompetitive settlement price for this plan and for other plans or a complete inability to purchase the necessary annuities. Particularly in the event of both an insolvent sponsor and an under funded pension plan, if we focus on the benefits in excess of those guaranteed by the PBGF, all plan participants would be better served by continuing to run the plan in a reduced risk fashion, possibly just for a few years, depending on how large the plan is, rather than force an annuity purchase over a short period of time at unfavourable rates (and if we consider the impact of benefits provided by the PBGF, then it would be at the expense of other plans or the taxpayers that this plan's participants might not be worse off). An example of the alternatives for plan participants might be as follows:

- Almost 100% chance of receiving immediately 80% of their promised benefit (assuming an 80% plan solvency ratio and no other recourse); or

- Roughly, say, 90% chance of receiving over the next few years 90% of their promised benefit.

If participants (or the government-appointed administrator) were faced with this choice, we suspect they would choose the latter alternative.

The ACPM believes that annuity purchase on full wind-up should not be required when there is no practical market for such annuities. In the current environment, this would mean total annuity value in excess of about $500 million, although this could be applicable also in the range of $100 – 500 million (potentially at the option of the administrator and/or over a shorter target period).

Another alternative would be to allow retirees the option of choosing a lump sum transfer of equivalent value. We believe this option should be available not only in the case of large plans but in all cases.

With respect to plans where the pension payments vary based on CPI or some other measure of inflation, we believe that the annuity market is not efficient for any size of retiree group. We suggest in those cases to allow a similar approach of continuing to run a wound-up plan or, alternatively, we would prefer if the administrator had the option of converting the indexed annuities to other forms of annuities that have a reasonably equivalent value (for example with a fixed indexing rate).

6. <u>Surplus and Contributions</u>

Questions 6.1 and 6.2 of the Discussion Paper address the issue of increasing flexibility for plan sponsors to continue or increase contributions in the event of surplus in a pension plan. This issue is secondary to funding flexibility set out above. If the legislative and judicial environment encourages plan sponsors to contribute at minimum levels, then increasing the maximum permissible level of contribution is not a material concern. However, the ACPM is of the view that the current limits in the *Income Tax Act* are too low and should be removed altogether as unnecessary. A typical plan's asset allocation could cause the funded ratio to swing by 10% or more, one year in three.

7. <u>Benefit Reductions</u>

Question 6.2 also asks whether plan sponsors should be given latitude to reduce benefits under certain specified conditions. The ACPM believes that this flexibility should be introduced into the legislation, at least for ancillary benefits. For example, early retirement provisions that were introduced in an environment of excess labour supply may no longer make sense in an environment of labour shortages. Subject to the agreement of plan participants or their union representatives, a sponsor should be able to reduce benefits, in addition to the current ability to make this change with respect to future accruals. Plan sponsors and plan participants should have the flexibility to make such trade-offs.

8. <u>Contingency Reserves</u>

In an environment of inflexible funding, mandating the establishment of earmarked contingency reserves (Question 6.3) within a pension trust is counter-productive to the encouragement of new DB plans, especially as long as plan sponsors face the current lack of balance and unfairness in the allocation and ownership of plan surpluses. The objective of contingency reserves is to enhance benefit security. The ACPM believes that it would be preferable to meet this objective not by requiring specific additional contributions to fund that reserve but, rather, to let it evolve from good experience.

9. <u>Investment Oversight</u>

Question 6.4 asks whether a riskier investment strategy should be subject to special procedures or more intensive oversight. The ACPM believes that specific rules are not appropriate in either determining or overseeing investment strategy. Currently, the Administrator needs to exhibit prudence in setting investment strategy. The Prudent Person rules are sufficient for this purpose and by their nature need to be implemented on a case-by-case basis. Similarly, regulatory oversight needs to reflect both the Prudent Person rules and the fact that pension plans and their sponsors can be unique. It too needs to be implemented on a case-by-case basis.

10. <u>Benefit Security</u>

So far in this section we have commented on changes that would enhance the funding flexibility of DB pension plans without jeopardizing benefit security. Funding flexibility will remove disincentives for plan sponsors to contribute more than minimum statutory levels. In the interest of enhancing the security of DB benefits, we believe that the Expert Commission should consider recommending that incentives for sponsors to contribute beyond minimum levels be introduced into the Act. The following are examples of such potential incentives:

- each dollar of contribution beyond minimum levels could create more than a dollar of Prior Year Credit Balance;

- contributions beyond minimum levels could provide a reduction to either or both the annual filing fee or the PBGF assessment; and

- the Ontario Government could enter into discussions with the Federal Government to allow pension plan surpluses to be used as a way to pre-fund health care benefits for retired plan members.

11. <u>Conclusion</u>

We have provided our input on funding issues to the Expert Commission in order to assist it in meeting two of its objectives – encouraging DB pension plans in Ontario and safeguarding the security of those benefits. We believe that any changes to the legislative requirements should satisfy the following criteria:

- They should encourage well funded plans;

- They should mandate only minimum funding levels;

- They should provide incentives (or at least remove disincentives) for sponsors to fund beyond minimum levels; and

- They should recognize the appropriateness of having different rules that are tailored for the special needs of different types of risk-sharing arrangements.

PART THREE: REGULATORY PROTECTION ISSUES

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Introduction

This section of the ACPM brief examines, in some detail, a variety of issues lumped under the title of Regulatory Protection Issues. The issues are diverse. Some follow the questions as outlined in the Expert Commissions paper; others are issues we would like raised and discussed.

1. <u>ISSUE: THE PENSION BENEFITS GUARANTEE FUND (PBGF)</u>

The Expert Commission's Discussion Paper raises a number of issues in connection with the Pension Benefits Guarantee Fund (PBGF), a fund that is unique among Canadian jurisdictions. Questions 7.1, 7.2 and 7.4 go to improving the funding, structure or operation of the PBGF. This paper does not directly address these questions; any system at all will have the inadequacy and the inherent flaws referred to below.

There is no satisfactory way that the PBGF could operate that would be acceptable to employers, meet the expectations of plan members and collective bargaining agents, and not constitute an unfair and unreasonable burden on taxpayers. The ACPM believes that the problems that the PBGF is attempting to address should be addressed by proper funding rules.

Expert Commission Questions

7.1 Are the present rules concerning premiums, eligibility for protection and levels of protection appropriate? If not, how might these be changed in the longer term?

7.2 Is the PBGF adequate to meet foreseeable claims on it under existing eligibility rules? If not, should the existing rules be changed? Should the PBGF be more appropriately funded?

7.3 Is a guarantee fund, such as the PBGF, the most appropriate way to protect the interests of plan members and pensioners from the effects of plan under funding or the employer's insolvency? If not, what are the alternatives?

7.4 Should oversight of the PBGF continue to be assigned to Ontario's pension regulator or should it be moved to some other institution? What powers should the overseeing institution have to adjust premiums paid to and benefits paid from the plan?

7.5 What connection should any of the above changes have to rules governing the funding of pension plans?

The following are our responses to questions 7.3 and 7.5.

Some of the issues raised by the foregoing questions are identified in the Discussion Paper. The existing PBGF in Ontario is seriously under funded because of several very large claims. This has resulted in the government of Ontario assuming substantial obligations for political reasons, at expense to the taxpayer. Moreover, the level of benefits it provides is too low. Since the benefits depend on topping up the first $1000 of pension entitlement, it would be an unusual situation where a member would receive more than $200 or $300 per month. Member expectations, however, are for greater coverage as implied by the name of the PBGF. Further, because multi-employer plans are not covered, there is a sizeable segment of unprotected plan members.

ACPM Recommendation

Back from the Brink discourages the establishment of pension benefit guarantee funds, even though they have provided limited protection to plan members in some instances. But the reality is that those with the greatest need, members of under funded plans, often have employers with the least ability to pay for realistic insurance levels. Further, guarantee funds encourage practices that expose the funds to the risk of large claims i.e. benefit improvements in under funded plans or reckless investment policies. An unfair burden, relatively speaking, falls on employers with well-funded plans and prudent funding and investment policies. Guarantee funds in jurisdictions such as Ontario, the U.S. and the U.K. have not been financed using true insurance principles. Accordingly, they transfer risk from those with pensions, albeit under funded, to taxpayers generally, many of whom have no pensions at all. Further, guarantee funds distort regulatory or governmental intervention in under funded circumstances, as there is an inherent conflict in protecting plan members and protecting taxpayers.

2. ISSUE: SIGNIFICANT CHANGES IN PENSION PLANS – FINANCIAL CONDITION OF EMPLOYER

The Discussion Paper touches on one aspect of this issue in respect of the insolvency of the employer in questions 8.3 and 8.6 – that is the intervention by the regulator on the basis of the financial status of the employer or the plan. Seniority of pension funding in an employer bankruptcy is another important related issue that is not expressly articulated in the Discussion Paper.

Expert Commission Questions

8.3 Should the pension regulator retain discretion within certain parameters to order a wind-up when the viability of the plan is at stake because of corporate restructuring or threatened insolvency?

8.6 What would be the best approach to protecting the ongoing rights of plan members and pensioners, in the event of a material change in the identity, structure or financial circumstances of a sponsoring employer?

The insolvency of an employer with an under funded plan can obviously lead to a plan wind-up wherein members' benefits are in jeopardy to a greater or lesser extent. On the other hand, regulatory or legislative intervention causing a requirement for additional funding before there is an actual insolvency can itself create the insolvency, as in the Air Canada insolvency, or add uncertainty in attempts to deal with insolvencies, as in the Stelco CCAA proceedings.

Further, there is pressure to give pension funding a priority in bankruptcy. As it is, the amount of under funding is considered to be an unsecured claim, and the deemed trust provisions of the PBA do not prevail in a bankruptcy.

ACPM Recommendation

The protection of the plan members and the imperatives of corporate health and survival must be balanced. For corporate health and survival a lack of certainty as to whether there might be regulatory or legislative intervention can be very problematic.

The ACPM's position is that any additional obligations on employers who are at financial risk must be considered very carefully. Generally, funding requirements should arise from the financial condition of the plan, and not that of the employer. Uncertainty in this area, or on the other hand, precipitate action of the regulator, can have serious financial consequences to an employer otherwise in financial difficulties. Matters could be made worse overall. Further, it is not clear how any rules would be applied to companies in respect of which credit information is not publicly available.

There is no difficulty with requiring an annual valuation report when the funding of a plan drops below a certain legislated level. If there is a concern as to the financial condition of the employer, regulators should enter into discussions with the employer. If any regulatory action is available, it should be in accordance with clearly defined and articulated criteria, and upon full discussion with the plan sponsor.

As to seniority of pension funding in insolvencies, the ACPM has discouraged a change in the existing bankruptcy regime under which a wind-up deficit is an unsecured claim. *"Back from the Brink"* gives the more comprehensive discussion of the risks and challenges in giving pension funding a greater priority. Such a priority would cause an increase in the sponsor's cost of capital, leading to increased difficulties of raising capital for companies with significantly under funded plans. Lenders of capital might well insist on constraints around a company's pension plan (e.g., on benefit improvements, its funding strategy, or investment policy) to protect themselves, or even call for the freezing or the wind-up of the plan. Moreover, solvency valuations can be very volatile, and usually are not performed very frequently. In this context, it is not clear how a company's credit-worthiness would be determined.

A pension superpriority could have an impact on a company's share price (including the value of that company in the investment portfolios of other pension plans), and potentially affect the company's ability to meet debt obligations. If such superpriority were to be legislated (under federal bankruptcy laws), the transition to the new rules would have to be carefully thought out. Applying new rules retroactively could well be unworkable and some form of "grandparenting" would have to be considered (e.g., debt incurred before a certain date).

3. **ISSUE: SALE OF BUSINESS/CONSOLIDATION AND DIVISION OF** PENSION PLANS

The Discussion Paper raises the issue of how the PBA should deal with significant changes to the pension plan as a result of changes to the employment relationship such as in the case of a plan mergers, splits and restructurings.

Expert Commission Question

8.1 How should the PBA deal with plan mergers, splits and restructurings? How might such changes affect members? How might they affect funding?

Plan Mergers and Asset Transfers

A lack of clarity in the case law (namely the decision in *Aegon Canada Inc. and Transamerica Life Canada* v. *ING Canada Inc* ("*Transamerica*")), coupled with minimal legislation and restrictive policies developed by FSCO, have limited pension plan mergers and asset transfers in Ontario.

From an employer's or plan sponsor's perspective, prior to the recent developments in case law and regulatory policy, it was common for plan sponsors to merge a plan in surplus with a plan in deficit and to use the surplus in one plan to set off the funding obligations of the other. Moreover, the synergies a company may achieve with another company are usually important business considerations in a merger or acquisition. Therefore the ability to merge plans in order to facilitate benefit delivery, to transfer plan assets when undergoing corporate reorganization and to reduce administrative costs can be important to the employer's ability to conduct its business.

Following the *Transamerica* case, FSCO adopted a policy that imposes overly restrictive limits on the ability of plan sponsors to transfer assets of pension plans, effectively prohibiting the transfer of defined benefits in the vendor's pension plan to the purchaser's defined benefit plan. FSCO has taken the position that the Transamerica decision puts at question the ability to transfer assets between pension plan trusts – something which had been broadly accepted as permitted. Since that time, FSCO has imposed strict conditions in respect of applications for transfers of assets between pension plans, including mergers of pension plans operated by the same employer. Following an initial moratorium on the approval of pension asset transfer applications in early 2004, FSCO set out certain circumstances and conditions that must exist for a transfer to be approved. The imposition of these conditions and circumstances has essentially made asset transfers and mergers between defined benefit pension plans impossible in most cases. The application of classic trust rules to pension plans needs to be overridden by legislation to again allow sponsors to transfer defined benefits from one plan to another.

The transfer of defined benefits (and assets) in circumstances of corporate mergers and acquisitions is generally beneficial to affected plan members since it allows their benefits to be kept "whole" by permitting future salary increases to apply to benefits accrued in the vendor's pension plan. Otherwise, affected plan members' benefits would remain "frozen" in the vendor's pension plan in that the members' benefits would be determined based on their earnings up to the date of sale, generally without the benefit of including future earnings increases with the purchaser.

The transfer of defined pension benefits (and assets) on a corporate merger or acquisition is also beneficial to vendors since Section 80 of the PBA permits a vendor to transfer liability for such benefits to the purchaser on a sale or transfer. Section 80 of the PBA is specifically directed toward apportioning responsibility during corporate change. Section 80(2) specifically excludes any continuing obligation for benefit funding on a former employer where a successor employer specifically assumes responsibility for the accrued pension benefits of the affected employees. Defined benefit asset transfers are neutral with respect to the funding of the vendor's and the purchaser's plan.

Transfers of Identical Benefits v. Benefits of Equivalent Value

FSCO has also taken the position that, under the PBA, plan members whose benefits are being transferred into another defined benefit plan must be offered benefits identical in every respect to those provided in the exporting plan. The PBA should be clear that on an asset transfer the successor plan may provide benefits of equivalent value, or benefits that are reasonably equivalent, and not be required to provide identical benefits. Identical benefits are difficult for the importing plan to administer since a plan amendment is required and the benefits are different from those offered under the main plan formula with many of these differences being trivial.

Portability Option for Members on Purchases and Sales

In addition, where a vendor and purchaser have not agreed to a transfer of benefits and assets into the purchaser's pension plan, under the current provisions of Section 80 of the PBA members are not given an opportunity to choose to consolidate their pension assets in their new employer's plan where they are affected by a purchase and sale. Section 80(3) provides that where a transaction for the transfer of a business or its assets occurs, the employment of an affected plan member is deemed, for purposes of the PBA to have not been terminated. Therefore, the plan member is not entitled to take advantage of the portability/transfer provisions upon termination of employment with the vendor. Where benefits are not transferred by way of an approved asset transfer between the vendor's and purchaser's plan, members often end up with lower ultimate benefits and it is often difficult for vendors in these situations to communicate with former plan members with respect to their benefits and, in the case of defined contribution plans, in respect to changes to investment options available. It is also very difficult to continue to educate former DC members about investing in circumstances where the employment relationship has transferred to the purchaser. Allowing portability of benefits on the sale of business would be beneficial to both vendors and affected plan members for the same reasons described above. These changes would not affect plan funding. It is also important to note that plan members who voluntarily terminate may elect portability/transfer provisions, so it makes sense to allow a member to elect a transfer with respect to their new employer.

The operation of Section 80(3) has also had negative repercussions for the vendor's pension plan in a purchase and sale transaction. Section 80(3) deems a non-termination of employment under the vendor's pension plan. As a result of this provision, where there is no transfer of assets from the vendor's to the purchaser's plan, the vendor continues to be the employer of the transferred employees for purposes of the vendor's pension plan. When the transferred members' employment is subsequently terminated (sometimes many years after the transaction) by the purchaser, their "deemed employment" with the vendor for pension purposes is also terminated and results in a partial wind-up of the vendor's plan with the accompanying increase in costs and plan liabilities. The PBA should be amended to clearly provide that the subsequent termination of employment of transferred members by the purchaser can not trigger a partial wind-up in the vendor's pension plan.

Proportionate Share of Surplus on Transfer of Assets

On a plan split or asset transfer, the PBA does not clearly provide that a proportionate share of assets to liabilities (which would include proportionate share of surplus) must be transferred from the vendor's (exporting) to the purchaser's (the importing) plan. FSCO Policy Statement No. 2 provides that where a proportionate share of surplus is not transferred on an asset transfer, the transferred members retain a right to share in the surplus in the vendor's should the vendor's plan wind-up in future. However, in a 2005 decision of the Ontario Superior Court in *Burke* v. *Governor and Co. of Adventurers of England Trading into Hudson's Bay* the court found that the failure to transfer a proportionate share of surplus on a transfer of pension benefits and assets constituted a breach of trust on the basis that the transferred plan members had an expectation that surplus might be used for future benefit increases. The PBA needs to be clear on what obligation, if any, exists to transfer a proportionate share of surplus on a pension asset transfer or plan split. At the very least, clear criteria should be articulated.

Corporate Restructurings – No Partial Plan Wind-Up

With respect to restructurings, Section 69 the PBA provides that the Superintendent has the discretionary power to wind-up a plan, in whole or in part, where there is a change in the operation of the plan sponsor's business which affects a "significant number" of plan members who cease to be employed by the employer as the result of the discontinuance of all or part of the business or the reorganization of the business, or the discontinuance of a significant portion of the business at a specific location.

In addition, Section 69 of the PBA provides that on a purchase and sale transaction the Superintendent has the discretion to order a partial wind-up of a vendor's pension plan where the purchaser does not provide a pension plan for the transferred employees.

The ability to restructure is an important tool for a business to ensure it is competitive and sustainable. However, the threat of a potential declaration of partial plan wind-up with the accompanying increase in costs and plan liabilities interferes with this ability to restructure and has the potential of adversely affecting the company's economic health. Section 69 of the PBA should be amended to eliminate the Superintendent's discretionary power to declare a partial wind-up where a business restructuring, such as a downsizing program or plant closure, occurs and where the purchaser does not offer a pension plan to transferred employees on the sale of a business.

Corporate Restructurings into Partnership Structure

The PBA does not contemplate business restructurings involving the reorganization of a corporation into limited partnerships. The definition of "affiliates" under the PBA currently only refers to affiliates as defined in the Business Corporations Act (Ontario) and therefore does not include partnerships. The PBA needs to be updated to take partnerships into account as employers and administrators of pension plans.

ACPM Recommendation

The PBA ought to provide more flexibility in transferring pension assets and liabilities in sale, purchase and merger situations. The application of classic trust rules to pension plans needs to be overridden by legislation to again allow sponsors to merge or transfer defined benefits from one plan to another. This would facilitate restructuring to support economic growth in Ontario and fair treatment of employees and their pension rights in these situations.

As mentioned above, the PBA should also be clear that the successor plan may provide benefits of similar value, and not be required to provide identical benefits.

We believe that a plan should be allowed to offer portability in a sale or divestment situation whenever the member is in a pension plan and unable to accrue further benefits; i.e., where the assets and liabilities are not transferred to a purchaser's plan and the member has ceased to be an employee of the employer sponsoring the vendor's plan.

The PBA needs to be clear on what obligation, if any, exists to transfer a proportionate share of surplus on a pension asset transfer or plan split. The ACPM does not believe that such surplus should be required to be transferred.

Section 69 of the PBA should be amended to eliminate the Superintendent's discretionary power to declare a partial wind-up where a business restructuring such as a downsizing program, occurs and where the purchaser does not offer a pension plan to transferred employees on a sale of business.

The PBA needs to be updated to take partnerships into account as employers and administrators of pension plans.

4. <u>ISSUE: WIND-UP</u>

The Discussion Paper raises the issue of wind-up rules in subsections 8.2, 8.3 and 8.5 which are restated below for purposes of reference:

Expert Commission Questions

8.2 Should the same wind-up procedures apply to all kinds of pension plans, or do some require more intensive controls than others? Should wind-up procedures be simplified?

8.3 Should the pension regulator retain discretion within certain parameters to order a wind-up when the viability of the plan is at stake because of corporate restructuring or threatened insolvency?

8.5 Should partial wind-ups in Ontario be eliminated entirely, as they have been in Quebec? If not, should Ontario adopt clearer or different rules concerning the distribution of plan surpluses and the preservation of "grow-in" rights in the event of partial wind-ups?

A full wind-up occurs when a pension plan is terminated or discontinued in whole. This most often occurs when a business is shut down or when an employer becomes insolvent or bankrupt. A full wind-up is usually the decision of the employer. However the Superintendent can order that a plan be wound up in whole under certain circumstances. The assets of the pension plan are then used to meet the accrued benefit entitlements. These accrued benefit entitlements will take into account certain 'grow-in' rights. These rights are early retirement benefits the employees would have "grown into" had both the plan and their employment continued.

A partial wind-up can occur when a pension plan is terminated or discontinued in part. This generally occurs as a result of downsizing or re-structuring where the employment of a significant number of active plan members is terminated. A partial wind-up is usually the decision of the employer. However the Superintendent can order that a plan be partially wound up. The assets of the pension plan are then used to meet the accrued benefit entitlements of affected members. These accrued benefit entitlements will take into account the 'grow-in' rights.

We have no comment on the procedures for wind-up other than to note that, in our view, the current procedures (that distinguish between DC and DB plans) appear adequate.

The retention of partial wind-up legislation, particularly when aligned with the "grow-in" rights, should be thoroughly reviewed.

Why is Wind-Up an Issue?

"Wind-up" is an issue primarily for two reasons: (1) the application of the rules on full wind-up versus a partial wind-up and (2) the inclusion of "grow-in" rights on wind-up. In addition, the Discussion Paper raises the question as to what level of discretion the regulator should have to order a wind-up.

Partial Wind-Up

The rules surrounding partial wind-ups are unclear. As a result, there is some discretion afforded the Superintendent in ordering a partial wind-up. For instance a partial wind-up occurs when a "significant number" of employees have been terminated. However the PBA does not define "significant number".

The PBA contains wording governing the treatment of plan surplus on partial wind-up, which was clarified in 2004 by the Supreme Court of Canada (SCC). For many years, it was generally accepted that the law could be interpreted as conferring to those affected by the partial wind-up surplus entitlement at some future date if the whole plan were wound up. While this was practice for many years, the Financial Services Commission of Ontario ("FSCO"), for a filing by Monsanto, changed its practice in this regard with respect to a partial wind-up filing.

Monsanto challenged this change, ultimately to the SCC. In *Monsanto*, the SCC was asked whether the PBA requires the distribution of a proportional share of surplus when a defined benefit pension plan is partially wound up. The SCC ruled in favour of FSCO. As a result, the wording of the PBA requires that plan surplus (provided plan wording creates an entitlement) must be distributed at the point of partial wind-up, not at a future date.

ACPM Recommendation

Surplus existing on a partial wind-up should not be required to be distributed out of the pension plan, whether to the affected members or the employer, although such members may retain a contingent right to any surplus distributed at a future date if a full wind-up occurs.

However, if a distribution of surplus continues to be required, the PBA should be amended to provide for the employer to have the ability to withdraw surplus if it can demonstrate entitlement <u>or</u> it obtains the consent of two-thirds (2/3) of plan beneficiaries.

The concept of partial wind-up should be removed from the PBA on a prospective basis. This recommendation has already been implemented successfully in another province, and we believe it is the best solution to this issue. The ACPM recognizes that elimination of partial wind-ups could have an impact to grow-in benefits, however, we believe that grow-in should be addressed as well.

A limitation period should be imposed on the Superintendent's authority to declare that a partial wind-up has occurred related to past events.

5. ISSUE: DISCRETION OF REGULATOR TO ORDER A WIND-UP

Broad discretionary power on the part of the regulator is problematic. It creates uncertainty for employers and businesses. Employers must bear the risk of regulatory action at any time in respect of past events of which the employer may have no prior knowledge, especially where the plan was assumed in a merger or acquisition.

Continuing to provide the regulator with broad discretion to declare a partial plan wind-up creates inequities since it is doubtful that such discretion can be exercised evenly as a result of the complaint driven process followed by FSCO.

ACPM Recommendation

In response to Expert Commission question 8.3, the ACPM's position is that the Superintendent should not be granted broad discretion to order a wind-up but that the circumstances in which a wind-up could be ordered be clearly articulated in the legislation.

6. ISSUE: GROW-IN

Grow-in rights entitle certain employees of wound-up plans not only to the pension benefits that they had earned up to the wind-up date, but also to the early retirement benefits that they would have "grown into" had both the plan and their employment continued. A wind-up, be it full or partial, will trigger legislated benefit enhancements under defined benefit pension plans, thereby increasing plan liabilities particularly in plans with generous benefits. Ontario and Nova Scotia are the only jurisdictions in Canada that impose grow-in requirements. The primary problem in Ontario (Nova Scotia does not require funding of grow-in rights) is that grow-in can create a heavy funding burden on the pension plan.

The liabilities for "grow-in" rights are significant when either a partial or full wind-up occurs. In addition, these liabilities have to be taken into account in any solvency valuation. Only Ontario and Nova Scotia pension legislation include such rights. Nova Scotia however has moved in recent years to revise their legislation. For instance, multi-employer plans are no longer subject to the "grow-in" rules. For other plans, Nova Scotia removed the requirement to fund "grow-in" benefits under a solvency valuation.

The Nova Scotia model incorporating the concept that one set of rules do not have to apply to all plans has some merit, particularly as a potential middle ground for consensus.

ACPM Recommendation

The ACPM advocates the elimination of grow-in benefit entitlement under the PBA.

The ACPM supports the elimination of prescribed grow-in entitlements for three reasons:

- eliminating grow-in is a step towards uniform pension standards legislation across Canada;

- grow-in provides a windfall benefit to members who happen to terminate membership in a wind-up or partial wind-up, but not in any other circumstances; and

- eliminating grow-in may encourage the establishment of defined benefit pension plans, as it removes onerous financial obligations on employers.

Uniform Pension Legislation

Eliminating grow-in requirements, and the associated concept of the partial wind-ups, is a step towards harmonized pension standards legislation across Canada. We note that the CAPSA Model Law principles do not provide grow-in. At this time, only two jurisdictions prescribe grow-in entitlements on a wind-up – Nova Scotia and Ontario.

It appears that grow-in benefits are arbitrary (age plus service equals 55 points) and inequitable. If the intention is to protect older workers, it may not do so. If the intention is to protect those who lose their jobs in a group termination, it does not do so equitably. It also does not provide any protection for those members of a pension plan who do not have 55 points at the date of wind-up.

Financial Impact

The ACPM also submits that grow-in requirements impose financial burdens on plan sponsors that ultimately act as a disincentive to the growth of defined benefit pension plans. Furthermore, although placing considerable financial obligations on the employers/plan sponsors who give early retirement benefits in their pension plans, the grow-in requirements benefit few employees. First, the plan must offer early retirement benefits. Second, the members must have 55 points. Third, there has to be an actual wind-up or partial wind-up for the benefits to be given. The result is that one group of terminated members may have an advantage over other terminated members or, for that matter, an advantage over current active and retired members.

Employers in Ontario must incorporate grow-in into their solvency valuations, forcing pension plans to be funded at a higher level that would be necessary without the grow-in requirement. This places a considerable financial burden on employers, yet will only benefit plan members if the plan winds up. ACPM is concerned that grow-in requirements are anti-competitive and discourage employers from providing early retirement benefits. If some groups consider grow-in important, the PBA should permit such provisions to be allowed in plans which choose to do so, or where they are bargained.

ADDITIONAL REGULATORY PROTECTION ISSUES AND REFORMS

The following regulatory issues are not specifically addressed in the Discussion Paper or do not clearly fall within any of the categories of questions posed in the Discussion Paper. Nonetheless, ACPM is of the view that these issues are of sufficient importance to merit consideration by the Commission.

7. ISSUE: PENSION DIVISION ON MARRIAGE BREAKDOWN

Pension division on marriage breakdown is one of the most costly, time-consuming and difficult areas of pension administration, especially for multi-jurisdictional plans. Different valuations of pensions for purposes of equalization of family property under family law and for purposes of pension splitting under pension legislation lead to great confusion, both among the family law bar and the judiciary. As a result, it is frequently difficult for plan administrators to apply the terms of divorce judgments and separation agreements within the context of the PBA. This frequently leads to additional cost being borne by all parties, as they are sent back to clarify the intent of the judgments and orders.

Pension as Family Property

The *Family Law Act* (Ontario) defines interests in pension plans as property that is subject to division on marriage breakdown. At present, all family property, other than pension entitlements, is valued and divided as of the date of separation. The ACPM understands that the policy principle behind the valuation and division as of the separation date is to permit spouses to achieve a full and final asset split. We query why the pension asset would be treated differently.

Transfer Method (Immediate Settlement) vs. Deferred Settlement Method

The ACPM prefers and advocates the Transfer (or Immediate Settlement) Method to the Deferred Settlement Method. In our view, the Transfer Method provides the following advantages:

1. The non-member spouse is able to receive a share of the value of the pension benefits as at the date of separation without the risk of future contingent events.

2. Spouses will not be put in the position of having to maintain ongoing relations strictly for the purpose of future pension entitlements.

3. Plan administrators will not have the additional burden of tracking those members whose benefits are subject to future pension division.

4. For DC Plans, the non-member spouse will be able to manage the investment of the transferred assets in a way that best suits the investment objectives of that individual, rather than being subject to the investment decisions of the member spouse.

5. The Transfer Method will ease the administrative burden for pension plans already shouldering significant regulatory complexity by not requiring the addition of non-employee, non-survivor "members" to their systems.

6. The Transfer Method can include clearly defined methodology to apply in all cases, minimizing the likelihood that plan administrators will receive a court order or separation agreement that has different possible interpretations or that is so unclear that the administrator is unable to interpret or administer it.

7. By dealing with the division of pension assets at the time of separation, it avoids the problem under the present system where the parties are required to re-visit an unclear provision on pension division many years after its drafting, when the parties do not recall the intent and the original counsel are not available. The goal should be to minimize the need for the parties to have to incur additional costs to negotiate the pension division issue in isolation at a later date.

The plan administrator issues raised above can be of particular concern to smaller employers and plan administrators. These administrators have few resources (both financial and personnel) and any revision to the legislation that will ease the burden of administering pension plans, and defined benefit plans in particular, is good for the health and coverage of the pension system in Ontario. While it is our understanding that some larger, public-sector plans have started to refer unclear court orders and separation agreements to court for clarification (at the plan's expense), this is an option that is not available to smaller plans. The issue is better addressed through clear legislation and immediate settlement of benefits.

The argument in favour of the Deferred Settlement Method is that there may be post-separation events (e.g. passing certain service and age thresholds) that can significantly affect the value of the pension and that have been contributed to by service prior to the separation. This argument is correct, but is not necessarily consistent with the policy objectives underlying the division of family property. The value of many items of family property may be subject to future events. ACPM sees the following significant disadvantages to the Deferred Settlement Method:

1. There are assertions of member spouses trying to manipulate pension and retirement planning in order to disadvantage their former spouses.

2. The timing of the pension income commencement is solely within the determination of the member spouse, with no consideration of the requirements of the non-member, former spouse.

3. Frequently, the language in court orders and separation agreements to give effect to a deferred settlement is drafted in a way that is open to multiple interpretations or that simply does not make sense and cannot be interpreted, requiring the parties to renegotiate the matter many years after the original determination.

4. Often, a separation agreement or court order fails to set out what happens in all contingencies, including the death of either spouse, both before and after the pension begins. In a deferred settlement environment, the administrator may have to deal with such a situation where a death occurs years after the original counsel for the parties have disappeared from the scene or forgotten the matter, and the surviving party and the estate or family of the deceased spouse have their own agenda.

ACPM Recommendation

The ACPM favours the adoption of the Transfer or Immediate Settlement Method. If this method is adopted, plan administration will be simplified and the independence of spouses will be improved. While it is true that the division of a pension on marriage breakdown may prejudice the non-member spouse in some circumstances from the perspective of perfect equity, so might the valuation of a house or cottage property prejudice one of the spouses. There is no perfect equity in marriage breakdown situations, but there should be a practical and cost efficient way of dealing with pensions.

We note that Quebec adopted the Immediate Settlement method in 1990. Our Quebec members report that the Immediate Settlement rules work well and there is little complaint about the approach.

8. <u>ISSUE: LOCKING-IN</u>

In recent years, there has been great debate over the issue of the locking-in of pension funds after a member's termination of employment. Those challenging the locking-in rules do so on the basis that it is their money and that they should have the right to determine how they use their funds. They eschew the paternalism that exists in the current locking-in regime and argue that the limited unlocking exceptions are not sufficient.

At the same time, those arguing in favour of the *status quo* often do so on the basis that pensions, and the terms associated therewith, form part of the employment contract. The basis of the pension plan is to provide retirement income and the pension funds should be used to provide retirement income. That is the common understanding of employers and employees when pension membership commences.

When locking-in was introduced in pension legislation, there were only very limited circumstances under which pension funds could be unlocked. In recent years, legislators in various Canadian jurisdictions, including Ontario, have softened the locking-in standards, allowing unlocking of all or a portion of an individual's pension benefits in other situations, such as financial hardship and shortened life expectancy. Some jurisdictions allow individuals who have been resident outside Canada for longer than two years to unlock their entire benefit. Several jurisdictions allow the unlocking of a portion of one's pension benefits upon attaining certain age thresholds.

As one considers whether Ontario should provide more flexibility for unlocking, there are a number of issues to consider:

Administration of Locking-In has Become Complex

Pension regulators and financial institutions have created a very complex system to ensure locking-in and to administer locked-in retirement accounts. Is this complexity practical or even necessary to protect the retirement savings of the minority of citizens that are members of registered pension plans?

The mobility of employees and the restructuring of employers have both resulted in a proliferation of locked-in retirement accounts in Canada. As more employees move freely from employer to employer, no longer expecting to work for the same organization throughout their careers, the numbers of locked-in accounts will increase. At the same time, the increase in RRSP contribution limits, increased discussion in the popular media about retirement savings needs, and an expansion of the financial planning market have all contributed toward an increase in the number of individuals with personal retirement savings plans. Employees lose track of the difference between their locked-in retirement accounts and their regular RRSPs and financial institutions have inadvertently unlocked funds that should have remained in a locked-in account.

Ontario has determined that funds can be unlocked in certain cases, including financial hardship. This has led to another level of bureaucracy where tax dollars are required to pay the personnel and infrastructure costs of managing these exceptions to locking-in rules. As the availability of this option becomes more widely known, the costs are very likely to increase.

Notwithstanding the foregoing, is the administrative complexity a necessary evil to permit the achievement of social policy goals related to retirement savings? While the average citizen may have the knowledge and understanding to appreciate the benefit of retirement savings, should we continue with the locking-in regime as a consumer protection measure to address needs on a lowest common denominator basis? If one subscribes to these notions, then the administrative complexity is a small price to pay.

A Total Compensation Perspective

Regardless of whether an employee participates in a pension plan, all Ontarians must recognize and understand the components of their annual total compensation that are being allocated toward their retirement income. For those participating in a defined contribution plan, that component is very clear. It is an ongoing challenge of plan sponsors to ensure that defined benefit plan members understand the value of their compensation package. For individuals who are not members of a pension plan, a portion of their compensation will also be required to fund their retirement years.

There is a growing awareness of the personal responsibility to plan for retirement, just as there is personal responsibility for meeting other financial obligations. Employees have diverse needs, priorities and values that change over their working lives and, consequently, want the flexibility to make choices that fit their needs and priorities. We believe it is appropriate to ask: Should the policies of government and former employers interfere with Ontarians' ability to make choices about their personal financial circumstances?

Employees have the ability to choose how they spend the great majority of their salary and wages. They enter into financial contracts and purchase homes whose value may far exceed that of their retirement savings. However, it is only retirement savings that is regulated in a way that is not consistent with how most people are able to manage the other financial decisions in their lives.

At the same time, it is possible to argue that while many Ontarians have the knowledge and capability to make appropriate choices, there are those who, for varied reasons, may not be able to properly evaluate what is a most appropriate use of their retirement savings. Pension plans are designed and structured with a particular objective, to provide a retirement income. Unlocking and the removal of lump sum amounts is not consistent with that objective.

Individual Choice vs. The Employment Contract

Many Ontarians do not participate in registered pension plans and are therefore responsible for determining their own retirement income security requirements beyond that provided by government programs.

Portability at termination of employment generally converts the defined benefit pension promise to a lump sum amount representing the value of the pension accrued during the period of plan participation. The result is comparable to the savings accumulated out of current compensation in a personal RRSP. The former pension plan member is at a disadvantage relative to non-member individuals for whom the savings regulations are less restrictive. A non-member individual can adjust their savings patterns and access previously allocated retirement savings in response to changing circumstances in their lives (e.g. life cycle needs such as marriage, home ownership, children, eldercare). By contrast, the former plan member accepted the arrangement with the plan sponsor to dedicate a portion of compensation specifically for retirement, as part of the employment contract, and cannot, as a consequence, make choices for the earlier use of those retirement savings.

Plan sponsors have come to fully support portability. Many sponsors continue to have a strong opinion about the preservation of the locking-in requirements. As stated above, when an employee becomes a member of a pension plan, the employee effectively agrees that the pension funds will be used to provide the employee with retirement income. They are not intended for lump sum withdrawals as a result of unlocking.

Strain on the Social Welfare System

Some stakeholders contend that access to retirement accounts for use other than retirement will ultimately put a strain on the social welfare system. With the increased focus on retirement savings, one can expect that this strain would only result from those who are truly disadvantaged or irresponsible.

Many individuals now seeking to access their retirement accounts for financial hardship reasons may be doing so solely to avoid having to access welfare programs. The funds accessed may serve a useful purpose in supporting the recovery of those individuals so that they do not have to rely on the social welfare system.

For the most disadvantaged or irresponsible individuals who seek access to their retirement accounts, such funds will reduce the shorter-term burden on social welfare and serve to provide an outside chance for recovery. It is possible that these individuals would rely on the social welfare system in any case. It is unreasonable to assume that the small cohort of individuals seeking to unlock funds from their locked-in accounts (if permitted) will ultimately place a material strain on the social welfare system.

Is there not a greater risk to the social welfare system from those who do not participate in pension plans? If locking-in is integral to the strengthening of Canada's social security programs, then perhaps it should be extended to all retirement savings. This idea may be considered inappropriate in some circles.

The increased focus on retirement savings has resulted in individuals taking responsible steps to plan for their retirement with both locked-in and non-locked-in retirement accounts. Unlocking all retirement accounts would likely not change the behaviour of the vast majority of Ontarians.

Human Resource Management

Unlimited unlocking could present a risk to the human resource planning of plan sponsors. It is possible that some members could terminate employment to access locked in funds. This would have an impact on both the employer and the pension plan:

1. Pension benefits would have to be valued on a commuted value basis assuming the member would have elected the maximum benefit value, further straining plan funding.

2. The employer may risk losing a valued employee at the peak of the employee's career.

3. Employers may have pressure from employees to terminate them and then re-hire them, leading to a multitude of human resource management issues.

Financial Hardship & Shortened Life Expectancy Unlocking

If locking-in is retained, the process for unlocking on financial hardship requires reform. The current process requires an extensive application process that is too complicated for many individuals to complete without assistance. If an applicant is able to complete the application process, they then face an assessment by FSCO staff that, based on the experience of ACPM members, appears to be subjective and lacking consistency in the criteria applied to determine whether unlocking should be granted.

By contrast, the terms of payment of a pension or deferred pension may be varied in the event of shortened life expectancy. The PBA and the regulations clearly set out the conditions to be satisfied to qualify for such a variation. Such a variation can include a simple unlocking.

ACPM suggests that the process for seeking unlocking due to financial hardship be simplified and that the criteria to be applied be made objective to the degree possible, thus adding transparency to the process. If an individual is facing financial hardship, she is certainly not able to incur fees or expenses to obtain professional assistance to complete a complicated application. An individual should also have an opportunity to determine in advance if she will qualify for the unlocking.

ACPM Recommendation

The issue of unlocking is one that is subject to many divergent views and arguments. A particular individual's position may not be easily categorized on the basis of having a management or a labour orientation.

In considering the future of unlocking in Ontario, there are a few matters that ACPM views as critical:

1. Creditor protection of pension funds is critical and must be maintained. There should be no compromise on this position for locked-in funds. For funds that have been unlocked, creditor protection should be maintained for funds that are directly attributable and identifiable as having been locked-in funds.

2. The administrative rules associated with the various forms of locking in and unlocking should be simplified to reduce the cost and complexity associated with the pension system.

9. ISSUE: PORTABILITY ON TERMINATION OF EMPLOYMENT

As job mobility increases, a smaller proportion of working Ontarians are spending their entire career with a single employer. Workers can accumulate pension savings at a number of different employers over the course of their working careers. This makes it much more difficult to qualify for pension enhancements, such as subsidized early retirement, enjoyed by long service members of DB pension plans.

The portability rules currently in the PBA provide that a pension plan member, on termination of employment, is entitled to retain the benefit in the pension plan or to transfer the value of the member's pension to a locked-in vehicle or to the pension plan of a subsequent employer if the subsequent employer agrees to accept the transfer.

The pension system could benefit greatly from revisions to the PBA that encourage and facilitate the portability of pension benefits. There are both member and employer elements to this. It should be as easy as reasonably possible for members to consolidate pension benefits. Under the current system, transfers to retirement accounts and income funds are fairly easy.

From an employer's perspective, the ability to force out DC benefits and small DB benefits of terminated employees, effectively a forced portability, would be beneficial. This could be modelled on the legislation in British Columbia and Alberta. Such an option would enable employers to reduce the cost of operating pension plans by not having to track numerous former members with smaller benefits, while encouraging employees to consolidate pension benefits from various employers. The practical issue in the British Columbia and Alberta legislation is that the employer still cannot act without receiving instructions from the member about where to direct the funds. We propose that this can be rectified by establishing a provincial agency that can receive, hold and manage these funds which should be invested in a balanced portfolio. This also presents a benefit to members since they could have one stop to obtain accrued pension funds, rather than having to pursue multiple former employers.

Strengthening the requirement for pension plan members to exercise their portability options has several benefits for the pension system:

1. Plan administration is made more cost-effective and efficient if a plan administrator no longer has to track the addresses and benefits for former employees. The number of records the administrator has to maintain is reduced. With that would come a cost savings from not having to attempt to locate missing members who might have terminated employment many years earlier.

2. Workers benefit since they would be able to consolidate more of their pension savings. One benefit of this is a reduction of the risk that with the passage of time a worker will forget about pension benefits he might have had with a former employer and not claim them when entitled to do so.

3. The Ontario economy benefits since the pension money members receive will in most cases be invested in the private sector.

ACPM Recommendation

ACPM proposes that it be made easier for plan sponsors to require a former member to exercise a portability option. This will significantly reduce the administrative burden and expense on plan administrators and will significantly increase the likelihood that employees will have consolidated retirement funds.

10. ISSUE: LOST OR UNLOCATED FORMER PLAN MEMBERS

A significant problem in carrying out a plan wind-up is locating members. Despite plan administrators' best efforts, often members cannot be found. Plan administrators and sponsors wrestle with the time and cost necessary to go through various sources and services and, especially in full wind-ups, the need to keep the pension fund open for a prolonged period of time.

ACPM Recommendation

ACPM proposes the establishment of a depository for pension entitlements of members affected by a wind-up who have not responded to the distribution of a wind-up statement within a reasonable period of time. While other provinces make available public trustees for these situations, Ontario has no public means to address the lingering liabilities of members who cannot be located. In this regard, the ACPM notes the passage of the *Unclaimed Intangible Property Act*, R.S.O 1990, Chapter U.1, which, if it were to be proclaimed in force, would provide a source for unclaimed pension entitlements.

11. ISSUE: NO LIMITATION PERIOD FOR REGULATORY PROCEEDINGS

The PBA currently provides for a five year limitation period for prosecutions under the Act; that is, five years after the event occurred or is alleged to have occurred.

Prior to the 1997 revisions to the PBA, the statute provided for a five year limitation period for proceedings under the Act.

The removal of the limitation period for regulatory proceedings causes uncertainties that are harmful to the conduct of business in the normal course. First, it permits the institution of regulatory proceedings with respect to events that were permitted by the common practice of the time but are not now permitted because of judicial decisions; for example, plan mergers, or partial wind-ups where there was no distribution of surplus. Secondly, it permits regulatory proceedings as to events that took place many years ago when all the individuals involved may have changed employment or retired, and/or where recollections are dim and documentation has been lost or destroyed. The expense of recreating the past can be huge. Thus governments enact limitation statutes.

ACPM Recommendation

We do not advocate that beneficiaries under pension plans lose their right under the Limitations Act (Ontario) to take what legal action they see fit to take, but rather that the lack of limitation periods under the PBA does not afford them retrospective rights through regulatory proceedings that are not available to litigants in non-pension matters.

A limitation period of five years from the event giving rise to such proceedings appears reasonable.

12. ISSUE: PHASED RETIREMENT

The PBA does not allow a plan member who has not reached normal retirement age to elect to begin payment of his or her pension while he or she continues employment. The member must first terminate employment. The federal government has announced changes to the *Income Tax Act* that will allow payment of pensions while a person continues in employment; so-called phased retirement. The ACPM supports the additional flexibility that is contemplated by the proposed changes to the *Income Tax Act*.

ACPM Recommendation

The ACPM proposes that the PBA be amended to allow, but not mandate, payment of pensions while a person continues in employment, to the fullest extent permitted under the *Income Tax Act.*

PART FOUR: OTHER ISSUES

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Introduction

In this, final, section of our brief, we address a number of issues which did not fit into the other sections of the brief.

1. <u>ISSUE: SUFFICIENCY OF LEGAL CONTEXT</u>

Expert Commission Question

1.5 In light of recent court decisions, are appropriate legal rules in place to protect the interests of present and prospective pensioners, and of employers who sponsor plans?

ACPM Recommendation

Reform legislation has, in some instances, been recognized by the courts as displacing the common law. In light of that:

- The PBA should be amended so that the method used to fund a pension plan (e.g., trust, insurance, pension fund society) does not in and of itself have an impact in determining questions of entitlement.

- The PBA should also be amended to provide that it is permissible for an employer and administrator to distinguish between active and non-active members, just as it is possible to distinguish among groups of active members.

For both of these issues, the legislation needs to be clear that it displaces the common law, so that employers and their employee groups are not so circumscribed by trust law in what are really matters of contract law.

(a) Override of trust law

The common law currently uses differing frameworks depending on whether the plan is subject to a trust or not. The differing frameworks are one of the elements that have given rise to lack of fairness and asymmetry as identified by the ACPM and others. Eliminating this distinction would be consistent with the "levelling the playing field" actions that have occurred in other areas of pension regulation, e.g., CAP Guidelines, *Income Tax Act* (Canada).

In our view, prior to the Supreme Court of Canada decision in *Schmidt,* the use of trusts to fund pension plans was done on the assumption that a pension trust is a more flexible vehicle than the courts have subsequently found it to be. The development of the common law in conjunction with certain historical events, including past requirements of federal taxation authorities, has resulted in older trusteed pension plans being subject to a different legal standard than newer plans, including newer trusteed pension plans (e.g., CRA no longer requires "exclusive benefit" language as a condition of registration which, in turn, makes it easier for an employer to be entitled to surplus on wind-up).

An amendment of this nature, although ambitious in scope, would not be out of step with the overall focus of reform legislation. It would also be a statutory step to redress the imbalance that numerous decisions have created between employers and employees. In this regard, even the Supreme Court in *Monsanto* acknowledged that it is a delicate balance. ACPM's view is that the balance has tipped in a way that is detrimental to employers and that is ultimately detrimental to employees. That balance can be readjusted by legislation.

The ACPM does not, however, advocate a change in the fiduciary standard applicable to the administration and investment of the pension plan and pension fund.

(b) Permitted distinction between active and inactive members

Trust law analysis, whether explicit or implicit, has resulted in application of the "even hand" rule, i.e., that a trustee must treat all beneficiaries alike regardless of there being classes of beneficiaries, e.g., active, deferred, retired, surviving spouses. The application of the even hand rule is a strict application of classic trust law, such as it would apply to a trust for an individual's minor children; in that instance, the law would typically require the trustee to treat the children in the same manner. Applying that rule strictly across classes of members to say that inactive members get the same benefit increases as active members does not recognize a key distinction between actives and inactives, i.e., the employment relationship that gave rise to the obligation for an inactive, has ended. Thus, it needs to be clarified that once the promised benefit has been provided, members should have no further claim to additional benefits absent a legislatively articulated trigger event, such as wind-up.

2. ISSUE: STRUCTURE, HARMONIZATION, CHECKERBOARDING AND THE ROLE OF INTERPROVINCIAL ARRANGEMENTS

Expert Commission Question

9.1 Should Ontario be seeking to replace or reinforce existing interprovincial arrangements that give it responsibility for pension plans with members outside the province?

ACPM Recommendation

Checkerboarding

"Checkerboarding" refers to the concept that the rules applicable to a person's pension are those that apply where the person earned the pension (which could include several jurisdictions). Under "final location", on the other hand, the rules of the jurisdiction in which the person last earned benefits apply to all benefits under the plan.

Checkerboarding should be removed by statutory amendment in favour of final location. Checkerboarding is virtually impossible to administer. For the law to require something that cannot be met invites non-compliance and ultimately brings the law into disrepute. The government needs to consider how the period that precedes the formalization of final location should be addressed, if at all. That is, given that legislation is not retroactive unless it is specifically made so, the government would need to consider whether the statutory removal of checkerboarding would create more risk to employers than the risk it takes away.

Harmonization

The ACPM supports harmonization of pension law across all jurisdictions. It is not clear that the social and economic realities of any one Canadian jurisdiction are so different from other jurisdictions that all of them cannot have the same benefit provisions applicable to all members of a pension plan, e.g., there are now four different unlocking regimes in Canada, and many other differences are similarly trivial.

In a period in which legislation continues to diverge, a fundamental question is how Ontario should demonstrate that it is in favour of harmonization. One possibility involves looking for the most frequently utilized legislative solution on a given issue. Another possibility is using the CAPSA Model Law as the guide for reform unless there is a clearly demonstrable reason why it should not be used. A third possibility is that with the most plan members and the most plans under its registration, Ontario should reassert its role as a leader in pension reform and look to other jurisdictions to follow its lead.

Attachment 5 is a position paper produced by the ACPM on June 30, 2004 as input to CAPSA deliberations. It is attached for the Expert Commission's information and provides further discussion.

Reciprocal Agreement

As a political matter, harmonization has proved to be extremely difficult, both in pensions and in other areas, most notably securities regulation. Given that harmonization appears to be many years away, the interprovincial reciprocal agreement is a necessary but ultimately suboptimal solution. It should not be viewed as the final solution. At a minimum, the inter-provincial agreement should be revised to clarify that only the administration rules (e.g. funding, pension committee, investment) of the province of registration apply.

3. ISSUE: JOINT ADMINISTRATION OF PENSION PLANS

Expert Commission Question

4.8 Would joint administration of defined benefit plans, or other changes in their structure and governance, make them more attractive to employers or less?

Expanding the available options for employers and employees would be beneficial to the overall pension system. ACPM feels that on the whole existing models of plan governance work well with the caveat that other structures as referenced in the submission from ACPM that would ease the cost and complexity of the administrative and reporting burden would be attractive to plan sponsors.

Outside of the public sector and traditional MEPP's, it is doubtful that joint administration would entice many employers to establish or maintain DB plans. A thorough and objective analysis of the operation, skill levels and decision making capabilities of pension committees in other jurisdictions needs to be done before mandating such bodies. Joint administration does not necessarily provide enhanced quality of investment and strategic decisions; it just provides lay, sometimes unqualified, representation for members. Despite initiatives elsewhere, there is no evidence that joint administration necessarily improves governance, especially in smaller plans.

4. ISSUE: DEFINED CONTRIBUTION PLANS

The ACPM understands that the primary focus of the Expert Commission is DB plans, however defined contribution (DC) plans are playing a more prominent role in the retirement system in Ontario. In some cases they are the sole source of employer sponsored retirement savings. DC plans have been in existence in Ontario for many years but their numbers have increased in recent years in part as a response to employers' concerns about the funding of DB plans.

However there are issues with DC plans that need to be addressed. Inadequate enrolment, inadequate savings levels, disengaged members, inappropriate default choices, lack of understanding of the concept and importance of replacement income, excessive investment choice, the ability of plan members to share investment and mortality risk, plan costs and governance structures are examples of the kinds of issues at play in today's DC market that require examination.

The ACPM has formed a DC Issues Task Force that is considering these issues and potential solutions. The development of recommendations for best practices and the education of stakeholders is also a goal of this group.

CONCORDANCE

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Discussion Paper	ACPM Response	Discussion Paper	ACPM Response
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		9.6	15

ACCOMPANYING DOCUMENTS

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1. *Summary of Coverage Statistics for Various Countries* (Watson Wyatt Worldwide, Spring 2007)

2. *Back from the Brink: Securing the Future of Defined Benefit Pension Plan*s (ACPM, 2005)

3. *Dependence or Self-Reliance: Which Way for Canada's Retirement Income System?* (ACPM, 2000)

4. *A Retirement Income Strategy for Canada: Creating the Best Retirement Income System in the World* (ACPM, 1997)

5. June 30, 2004 Letter to Mr. Davin Hall, Policy Manager, CAPSA Secretariat – Re: *Proposed Regulatory Principles for a Model Pension Law*