



THE COLLEGES OF APPLIED ARTS AND TECHNOLOGY (CAAT) PENSION PLAN

Submission to the
Ontario Expert Commission on Pensions

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1. CAAT PENSION PLAN OVERVIEW

The CAAT Pension Plan (Plan) covers the employees of the 24 Colleges of Applied Arts and Technology (or Community Colleges as they are more popularly known) in the Province of Ontario.

The Plan commenced on June 1, 1967 when the Community College system was introduced.

From 1967 to 1994, the Plan was sponsored by the Ontario Council of Regents on behalf of the Province of Ontario. The Plan was administered on a third party basis during that period by the Ontario Municipal Employees Retirement System (OMERS).

From 1995 and onwards, the CAAT Pension Plan has moved from being under the sponsorship of the Crown to a completely separate jointly sponsored independent entity.

The CAAT Pension Plan has the following characteristics:

A. Jointly Sponsored

- i) Employers: The Boards of Governors of the 24 community colleges
- ii) Employees: Ontario Public Services Employees Union – OPSEU
(represents academic and support employees)
Ontario College Administrative Staff Association – OCASA – (represents management employees)

B. Bi-Cameral Governance Structure

- i) Sponsors' Committee
 - 4 Employer members
 - 4 Employee membersRole : Approve Plan amendments
Determine frequency of filing of actuarial valuations
- ii) Board of Trustees
 - 6 Employer members
 - 6 Employee members who represent Plan membersRole : Plan Administrator under the PBA
Responsible for investments and overall administration of the Plan

C. Multi-Employer Pension Plan (MEPP) under Section 8(1)(e) of the PBA

D. Jointly Sponsored Pension Plan (JSPP) under Section 1 (2) of the PBA

- Matching Employer/Employee contribution rates
- Equal sharing of surplus/funding of deficits

E. Valuation Results as of January 1, 2007

	<i>\$ Million</i>
Assets (actuarial value)	4,966
Liabilities	<u>4,936</u>
Surplus	30

F. Comprehensive Funding Policy adopted in 2006

Impact:

- i) Contribution rates increase over 3 years by 3%

		<i>Maximum Rate</i>
(Current)	January 1, 2007	9.1%
(New)	January 1, 2008	10.1%
(New)	January 1, 2009	11.1%
(New)	January 1, 2010	12.1%

- ii) Indexation in respect of service from January 1, 2008 contingent upon being fully funded.

G. Assets

- i) July 31, 2007 - \$5,379 million
- ii) Externally managed – 16 managers
- iii) Bonds – 3 managers (1 passive)
- Infrastructure – 2 managers
 - Canadian equities – 3 managers
 - U.S. equities – 2 managers (1 passive)
 - International equities – 4 managers
 - Currency – 2 managers

H. Membership - July 31, 2007

Active	17,641
Deferred	1,050
Pensioners	10,262
Total inactive	11,312
Total	28,953
Ratio of active to inactive	1.6 to 1.0

2. EXECUTIVE SUMMARY

The Expert Commission has set itself an extensive mandate that runs the gamut from a macro analysis of the entire pension system to looking at the administrative and regulatory details that plan sponsors face on a daily basis. While many considerations are plan-specific or administrative in nature, and therefore are of more interest to plan administrators than plan members, we feel that the most important question that the Commission needs to address is:

What is the appropriate legislative, regulatory and judicial framework for Ontario that will ensure Ontario employees have an adequate post retirement income?

The issue can broadly be defined as one of coverage – the percentage of the employed labour force that is covered by an employer or employer/employee sponsored occupational pension plan. In recent years, the number of employees covered by defined benefit (DB) plans has fallen dramatically.

Dissecting the issue of coverage, the problem is largely concentrated in the private sector. This is because most public sector employees belong, or have the opportunity to belong, to DB plans, and the self-employed can build up reasonable retirement savings through Registered Retirement Saving Plans (RRSPs).

For the private sector:

- coverage is declining.
- there is a trend to freeze accruals in DB plans and convert future accruals to defined contribution (DC) plans or close DB plans to new employees and offer them DC plans
- some employers are winding up their plans completely, and, at best, are putting in place Group RRSPs which, while DC in nature, do not have the safeguards that are inherent in DC plans .

Therefore, the objectives of any legislation resulting from the Expert Commission report should be twofold:

1. Arrest the wind-up or freezing of private sector DB plans
2. Encourage employers without any pension plan to establish a registered pension plan (RPP) – preferably a DB RPP - but even a DC RPP would be preferable to nothing.

To do this, a wholesale change in the legislative, legal and regulatory environment is required.

Ontario can be justifiably proud of its pioneering role in developing pension legislation that established minimum standards for plan sponsors and Ontario pension plan members. The legislation served its purpose well and was applied in an environment that saw pension coverage increase in both the public and private sectors. Unfortunately, in the last 20-25 years, the situation has deteriorated. The decrease in coverage is the result of an environment that has been characterized by private sector employers as anti-pension plan in general and anti-DB pension plan in particular.

We will first deal with the issue of coverage, and then provide specific recommendations on other issues that we have identified.

3. THE ISSUE OF COVERAGE

OVERVIEW

Pension coverage in the Ontario private sector has decreased both in absolute numbers and as a percentage of the paid labour force.

If this situation is not rectified, many future Ontario retirees will have to manage on an inadequate retirement income, resulting in a decreased standard of living and a possible social and financial burden to the Province. This need not be the legacy that the current generation of plan members and retirees passes on to its children.

We strongly endorse the Commission's analysis of ways to preserve and enhance defined benefit (DB) pension plans. This is not to say that defined contribution (DC) plans are inherently wrong – they are appropriate in some circumstances and are preferable to having no plan at all. However, we prefer DB plans because they are a more efficient way of providing a guaranteed income stream for the following reasons:

- A DB plan can pool investment risk – a group of investors can take more risk, obtain greater diversification and, over the medium to long term, obtain greater returns than most individuals in a DC plan who manage their investments on their own.
- A DB plan pools mortality risk in a more cost-efficient manner than can an individual in a DC plan who buys an annuity from a life insurance company.
- DB plans have economies of scale and institutional investment cost structures (which are lower) compared to retail investment cost structures for many DC plans.
- DB investments are managed by professional investment managers who are usually selected or recommended by someone with investment expertise. DC investments have historically been selected by the DC plan member who generally does not have the same level of investment skill.

As a result, the typical DC member's investment portfolio is invested in "safe" investments which are low yielding and often bought and sold based on the most recent historical experience. The consequence is that generally, the DC plan member pays too much and receives too little in return. This is a sub-optimal use of capital and the resulting income stream is less than what is possible or what is needed to provide an adequate post-retirement income.

CHALLENGE

If DB plans are so good, why doesn't every employer have one?

The last 20-25 years have been witness to a series of actions that have challenged the operation of pension plans, particularly DB plans. As we have stated and shall illustrate, this is largely a private sector problem.

THE NUMBERS

We have reviewed reports from Statistics Canada and the Financial Services Commission of Ontario (FSCO) and present a simple summary of the results and trends below:

1. Canada

	Public Sector	Private Sector	Total
A. Coverage as percentage of Paid Workers			
1992	92%	29%	45%
2006	84%	26%	39%
.B. Number of DB Members ('000)			
2003	2,378	2,163	4,541
2006	2,488	2,112	4,601

OBSERVATIONS

- Coverage continues to decrease in both public and private sectors
- DB Membership falls in private sector

2. Ontario

	Public Sector	Private Sector	Total
Number of DB Members ('000)			
2003	665	1,113	1,778
2006	712	1,015	1,727

Private sector DB Members are trending downwards at 3 percent per year. The above statistics are based on jurisdiction of plan registration. Statistics based on area of employment, which encompass Ontario members in Ontario registered plans, Ontario members in plans registered in other provinces and under federal jurisdiction show similar results and trends.

While these statistics are as of January 1, 2006, there is no reason to doubt that the downtrend in pension coverage and membership in private sector DB plans continues.

How did this situation emerge?

We believe the causes of the problem are multi-dimensional, and reflective of the number of players involved in the pension system. For the purposes of explanation, we have placed them into two broad groups. In Group A are those whose actions directly impact every pension plan. Group B can loosely be categorized as service providers.

Group A

- 1) Plan sponsor(s)
- 2) Plan administrator (if different from 1)
- 3) Plan members
- 4) Pensioners
- 5) Legislators – the Ontario Legislature
- 6) Regulators-Canada Revenue Agency
- 7) Regulators – FSCO

Group B

- 1) Judiciary
- 2) Legal counsel to Plans and/or Members
- 3) Actuary
- 4) External Auditor
- 5) Custodian and benefit payroll agent
- 6) Investment managers
- 7) Consultants (investment, plan design, governance, etc).
- 8) System provider

In Group B, each provides services to the plan for a fee, except for the judiciary. (The judiciary is included because it only gets involved in disputes between parties that cannot be resolved.)

To the extent that the constituents of both Group A and B can share in the successes of Ontario's pension plan system, each must also shoulder some blame for the problems that exist today.

The possibility exists that any one of these players, presenting from their own narrow perspective, may argue that they are not the cause of the problem but that everyone else is to blame.

At the risk of falling into the above trap, we at the CAAT Plan have tried in this submission to identify what we feel are the overarching themes that have caused many of the problems that plague DB plans and the Ontario pension system.

CONCLUSION

We believe the choice is this: a robust and expanding retirement system, or a continuing decrease in pension plan, and particularly DB pension plan, coverage.

The latter scenario may provide the illusion of retirement security for those plans that continue to exist, but at a cost of coverage for an increasing portion of the private sector labour force. We doubt this is the legacy that the Expert Commission wishes to enshrine.

We turn now to the recommendations (and supporting analyses) that we believe if implemented, would go a long way to ensure a dynamic and secure retirement income for current and future generations of Ontario workers.

4. RECOMMENDATIONS

4.1 SUMMARY OF RECOMMENDATIONS

If a key objective of pension legislation is to promote the maintenance and expansion of the DB pension plan, then the following changes need to be made.

Surpluses

1. Sponsors responsible for funding a deficit should be entitled to surplus and contribution holidays.
2. Surplus should not be withdrawn from an ongoing DB plan unless the funded ratio is at least 150% calculated on a solvency basis excluding smoothing of assets and liabilities and including any contractual indexation. The funded ratio must remain at least at 150% following distribution of surplus, including any court-mandated distribution.
3. Surplus should not be distributed on a partial plan wind-up.
4. For traditional DB plans where the employer pays the full cost, or the employee pays a fixed percentage and the employer pays the balance of the cost, the employer should be entitled to the surplus and the contribution holiday. For a new proposed type of DB plan where the employer pays a fixed percentage and the employee pays the balance, the employee should be entitled to the surplus and the contribution holiday. If the contribution costs are shared 50/50 between the employee and the employer, or if the contribution is funded according to a formula, the surplus and contribution holiday should be shared 50/50 or be allocated according to a formula, respectively.

Grow In Provisions

5. Grow-in provisions should be eliminated.

Solvency Deficiencies

6. Solvency deficiencies should be funded over 15 years instead of 5.
7. Where the period remaining in funding a solvency deficiency is more than 5 years, any improvement in plan provisions should be fully funded over 5 years.
8. The requirement for funding solvency deficiencies for Jointly Sponsored Pension Plans should be eliminated.

9. For DB plans where the employer pays the full cost, or the employee contribution is fixed and the employer pays the balance of the cost, the employer should make up any deficiency on a solvency basis only in the case of a total plan wind-up.

Pension Benefits Guarantee Fund

10. The Pension Benefits Guarantee Fund should be eliminated.

Administrative Issues

11. The provisions of the Ontario PBA should apply to all employees if they are members of a pension plan registered in Ontario, regardless of whether the employees are residents of the province.
12. Plan members should be obligated to confirm and/or correct data that pertains to the member on a timely basis.
13. Sponsors should not be obligated to produce previously provided information for plan members unless three years have passed since the last request.
14. Marriage breakdown should be treated as a pension event like termination – the member's benefit should be valued and distributed to the ex-spouse at the time of marriage breakdown.
15. The Annual Information Return should be combined with the investment report so that one report is filed with FCSO.
16. FSCO should significantly improve the skill levels of those auditing the investment and funding aspects of pension plans so that they could provide informed advice and feedback to plan sponsors.
17. Pensions payable to deferred pensioners who do not come forward by their normal retirement age should be reduced by the administrative costs incurred to locate the pensioner.
18. Plan members with service in more than one province should have all of their entitlements based on the jurisdiction where membership terminated.
19. DB pension sponsors should be able to file the valuation used to determine pension expense in their audited financial statements rather than the funding valuation.
20. Plan sponsors should be able to terminate members from the pension plan if members have not made a contribution for 24 months.

21. Pension plans should have access to the provincial government death registry to ensure the accuracy of their beneficiaries list.
22. Trust law should not be applied to pension plan governance issues. A new legal model should be explored that would better reflect the complexities, interrelationships and dynamic nature of pension plans.

Trustee Qualifications

23. The PBA should mandate that trustees should have a minimum level of skills or related experience. The level of skills should either be acquired before a trustee is appointed or at least a meaningful component must be obtained during the first term of appointment.

Income Tax Amendments

24. The Ontario government should urge the federal government to amend the Income Tax Act to: i) increase the surplus limit from 10% to 50%, ii) increase the maximum pension accrual from \$2,222.22 per year of service to \$5,000 and iii) increase the money purchase amount to \$45,000 based on the factor of 9 currently used to determine the relationship between DB and DC maximum entitlements.

Indexation

25. Sponsors should be permitted to curtail future increases arising out of guaranteed indexation for existing pensioners where a plan has a solvency deficiency.

Investment Regulations

26. The regulations governing pension plan investments should be modified to remove a number of maximum limits:
 - i) 10% investment in any non government entity
 - ii) 5% -15% - 25% limits on resource property and real estate investments
 - iii) 30% limit on the voting shares of a corporation

Part-Time Employees

27. Employers should have the right to provide a DC plan to part time employees in place of the DB plan offered to full-time employees subject to the requirement that the employer

contribution to the DC plan is the same as the current service cost to the employer for benefits accrued in the current year for full-time employees.

4.2 FURTHER DETAIL AND ANALYSIS OF SELECTED RECOMMENDATIONS

What follows are further details and analysis in support of **selected** recommendations, intended to augment an understanding of our rationale.

Surpluses

Recommendation #1

Sponsors responsible for funding a deficit should be entitled to surplus and contribution holidays.

A symmetry needs to be introduced in that the party that funds the deficit must be entitled to the surplus, either in the form of contribution holidays (or as an actual withdrawal from an ongoing plan only if the plan is excessively funded, i.e. at a funding level of at least 150%) or on a full wind-up.

Unless this is reflected in the PBA, the reality will be that private sector coverage under DB plans will shrink over time and many Ontario residents will retire with no or an inadequate employment-derived retirement income.

For now, we can summarize the feeling amongst private sector employers that this playing field is no longer level: employees have entitlement to surplus and employers are responsible for deficits. This is what has been referred to as “asymmetry”.

The choice is clear. Ontario can experience an intensely regulated and shrinking DB pension environment where there is a distinct lack of balance between who bears the risks and who reaps the rewards, or provide a balanced approach between risks and rewards for plan sponsors and members that will result in a greater percentage of the private sector work force that is covered by a secure DB retirement income.

Recommendation #3

Surpluses should not be distributed on a partial wind-up.

Section 70 (6) of the PBA addresses the issue of wind-up. As we have stated before, the issue with partial wind-ups is the distribution of surplus as if it were a full wind-up. As surplus cannot crystallize until a plan is totally wound up, this section needs to be amended to clarify that a member’s entitlement on partial plan wind-up is only the value of the benefit accrued to the time of partial plan wind-up.

For greater clarity, the member whose membership is terminated as a result of the partial wind-up is not entitled to any distribution of surplus either at the time of partial or total wind-up.

With respect to partial plan wind-ups, we reference the Monsanto decision. The regulator and the courts made the correct decision based upon the law as written. The problem is that the law was flawed. It attempted to crystallize a Plan's funding status at a point in time rather than treat it as an issue that is dynamic and always in motion. A surplus can only be confirmed with any certainty when a plan is totally wound up. To establish a surplus at a point in time in an otherwise ongoing plan and pay it out to a group of departing members is unjust. Their entitlement is the promised benefit, the same as any individual retiring or terminating member.

Recommendation #4

For traditional DB plans where the employer pays the full cost, or the employee pays a fixed percentage and the employer pays the balance of the cost, the employer should be entitled to the surplus and the contribution holiday. For a new proposed type of DB plan where the employer pays a fixed percentage and the employee pays the balance, the employee should be entitled to the surplus and the contribution holiday. If the contribution costs are shared 50/50 between the employee and the employer or if the contribution is funded according to a formula, the surplus and contribution holiday should be shared 50/50 or be allocated according to a formula, respectively.

Specifically, we recommend the following funding mechanisms and surplus and contribution holiday entitlements for DB plans:

- A is a traditional non-contributory DB plan where the employer pays for the full cost.
- B is a traditional contributory DB plan where the employee contribution is fixed and the employer pays the balance of the cost.
- C is a new proposed model where the employer cost is fixed and the employee pays the balance.
- D is a traditional MEPP where benefits are reduced if there is a deficit.
- G is a JSPP where the costs and funding of deficits are split 50/50 between employer and employee.
- H is a JSPP where the employer cost and share of funding of deficits are fixed multiples of the employee portions.

	Sponsor	Contribution Employee	Employer	Funding of Deficit	Surplus Entitlement(1)	Contribution Holiday
A	Single Employer	0	100%	Employer	Employer	Employer
B	Single Employer	Fixed	Balance of cost	Employer	Employer	Employer
C	Single Employer	Balance of cost	Fixed	Employee	Employee	Employee
D	MEPP	0	100%	Benefits reduced	N/A	N/A
E	MEPP	0	100%	Employer	Employer	Employer
F	MEPP	Fixed	Balance of cost	Employer	Employer	Employer
G	JSPP	50%	50%	Shared	Shared	Shared
H	JSPP	X%	Y%,>x%	Shared (2)	Shared (2)	Shared (2)

(1) for service after date x

(2) Employee share = $X\% \div (X\%+Y\%)$

Employer share = $Y\% \div (X\% + Y\%)$

e.g. if X% = 5%

Y% = 10%

Employee share = 1/3

Employer share = 2/3

For types A and B above, upon total wind-up of a DB plan or on a sale of business, the employer must make up any deficiency on a solvency basis (currently partially provided under Section 75).

For types A and B above, upon total wind-up of a DB plan where the employer is bankrupt and the plan has a solvency deficiency, the benefits for all active members, deferred members and pensioners in payment shall be reduced on a pro-rata basis. (Currently partially provided under Section 75.)

For types C, G and H above, upon total windup of a DB plan including cases where the employer is bankrupt, and the plan has a solvency deficiency, the benefits for all active members, deferred members and pensioners shall be reduced on a pro-rata basis. (Change from current Section 75.1 for JSPPs.)

The PBA needs to ensure that all types of pension arrangements (both DB and DC) are addressed in the act with sufficient provisions to ensure proper administration. In addition to the traditional DB Plan where the pension benefit is defined as a monthly pension plan, the PBA should permit a new lump sum DB plan. The lump sum is defined as a multiple of annual salary so that an employee at retirement receives a lump sum of X% of final, final average or career average salary. May be paid as pension from DB pension plan calculated as lump sum \div (100 – age at retirement). (This may require corresponding changes in the Income Tax Act.)

Example:	Annual accrual of 50% of salary.
Service	= 30 years
Retires	= Age 65
Final Salary	= \$50,000
Lump Sum	= 30 x 50% x \$50,000
	= \$750,000
Pension	= \$750,000 \div (100 – 65)
	= \$750,000 \div 35
	= \$21,429 per year

The lump sum may be permitted to earn a fixed rate of interest so that it becomes, in effect, a cash balance plan.

We have tied funding, and surplus ownership to the date at which the new PBA becomes effective to avoid retroactive application.

Grow-in provisions

Recommendation #5

Grow-in provisions should be eliminated

“Grow-in” provisions are included in Section 74(1) of the PBA. The intent of the grow-in provision – to protect older and longer service plan members upon involuntary termination of membership – is honourable. The reality is that employers see this as another impediment in continuing or establishing a DB plan. To remove this disincentive, we recommend the following:

- a) Exclude age and service incurred after the new PBA goes into effect from the age and service calculation for eligibility under 74 (2). In effect, this would grandfather only those who met the age and service factor of 55 as of this date.
- b) Exclude grow-in from solvency valuations as of this date but continue to recognize the

liabilities arising out of grow-in in any actual full or partial wind-up.

From a point of view of equity, grow-in advantages one group of members over another at time of wind-up, and this proposal removes this distinction as it will be phased out over time. Accrued rights, however, remain protected.

Solvency deficiencies

Recommendation #6

Solvency deficiencies should be funded over 15 years instead of 5.

Requirements to fund solvency deficiencies were implemented to shore up shortfalls where plans were at a risk of defaulting. However, the 5-year time period is too short. This results in accelerated funding relative to the 15 years allowed for funding going concern deficiencies.

As the funding of a member's benefit under a DB plan is over a long period of time (from the date of hire to the date of death of the last survivor could be up to 50 to 75 years) plans will go from periods of being in a surplus to being in a deficit and back again. Changes in investment results impact assets and changes in interest rates impact liabilities. Thus the funding level will be volatile over time. As a result, overly aggressive funding of solvency shortfalls – which over time will tend to be eliminated as market and interest conditions change – is viewed by plan sponsors as unnecessary and is yet again another impediment to DB plans.

As a result, lengthening the period of funding of solvency deficits to 15 years from 5 reduces volatility in contributions, better reflects the long term nature and cyclicity of funding DB plans and removes another disincentive for DB plans.

Recommendation #7

Where the period remaining in funding a solvency deficiency is more than 5 years, any improvement in plan provisions should be fully funded over 5 years.

A legitimate concern has been expressed that plans that are not fully funded worsen their funding position by improving benefits. In order to provide some measure of control over 'exuberant' increases in benefit provisions, we suggest that where the remaining period to fund all solvency deficiencies is more than 5 years, then all improvements in plan provisions must be fully funded over 5 years.

Recommendation #8

The requirement for funding solvency deficiencies for Jointly Sponsored Pension Plans should be eliminated.

Solvency requirements were brought in to enhance the security of pensions. This requirement is logically needed only for plans where there is a risk of default. This would apply to private sector plans and not to public sector plans. The Ontario government has even exempted some of its own plans from solvency requirements. The logical conclusion is that all public sector plans should be exempt from solvency valuations, as they have no practical risk of default. Many other jurisdictions exempt some or all of their public and para-public plans from solvency valuations. However, so that it can be demonstrated that the public sector isn't being favoured relative to the private sector, the exemption can be limited to JSPPs, theoretically applying to both the public and private sector.

Recommendation #9

For DB plans where the employer pays the full cost, or the employee contribution is fixed and the employer pays the balance of the cost, the employer should make up any deficiency on a solvency basis only in the case of a total plan wind-up.

As a surplus cannot be determined with certainty until a plan is totally wound-up, neither can a deficit. As a result, immediate solvency payments should only be triggered upon a total plan wind-up. As well, Section 75(1)(b) should be amended to delete paragraph (i) and paragraph (ii) should delete the reference to Section 74 for age and service after the effective date of the new legislation.

Pension Benefits Guarantee Fund

Recommendation #10

The Pension Benefits Guarantee Fund should be eliminated.

Pension Benefits Guarantee Fund is covered by Section 82 of the PBA. Similar to the motivation for implementing grow-in provisions, the intent of this provision was honourable but the concept and application are flawed. There has been enough experience with the Pension Benefits Guaranty Corporation in the U.S. to show there is never enough money in the fund to honour the claims made. The situation was compounded in the U.S. where certain industries (steel and airlines) transferred their unfunded liabilities from the shareholders to the state. For Ontario, special payments needed to be made to cover the claims arising out of Algoma Steel.

The result is that responsible employers, plan members and taxpayers subsidize or underwrite those that are not. One large claim can bankrupt the Fund requiring special infusions of cash

from the government. The total payout from the PBGF for the 4 years up to 2003 was \$13 million. Largely as a result of Algoma Steel, the payouts escalated to \$520 million for the 2 years from 2004 to 2005.

Administrative Issues

Recommendation #11

The provisions of the Ontario PBA should apply to all employees if they are members of a pension plan registered in Ontario, regardless of whether the employees are residents of the province.

The fact that Canada has 10 pension benefits acts in place makes no sense. There should be one act for all Canadian pension plans. However, since this is unlikely to ever happen, we would recommend that all the provisions of the pension act of the jurisdiction of registration apply to all members of the plan regardless of where they are resident.

Employers with employees in more than one province would have their administration simplified thus removing one of the main impediments towards the establishment and operation of a DB plan.

While this would require intergovernmental negotiations, at least this proposal is possible. It would be analogous to the “passport scheme” currently under discussion with the various provincial securities regulators.

Recommendation #12

Plan members should be obligated to confirm or correct data that pertains to the plan member on a timely basis.

Sections 27 and 28 of the PBA state that the obligation for providing statements is solely that of the plan administrator. There needs to be a corresponding obligation on the plan member regarding confirmation or correction of data that pertains to the member and timely submission of changes.

Recommendation #13

Sponsors should not be obligated to give previously provided information to plan members unless three years have passed since the last request.

We do not dispute the intent of Section 29 to enable members to access information from an obstructive plan administrator. However, this privilege can be abused by current or former members who are bent on harassing a plan administrator at considerable expense to the Plan and its other beneficiaries.

In order to protect legitimate requests but at the same time curtail abusers, we recommend the following changes:

- a) Where prescribed information has previously been provided, it need not be provided by the plan administrator on subsequent examinations,
- b) Where a plan administrator has previously provided the required information, a subsequent request for examination by the same person may only be made three years after the last examination,
- c) The PBA needs to allow plan administrators to limit the length of any examination under 29(2)(a) and (b) to one business day.

As a member already has the right to review these documents at FSCO, all examinations after the initial one need only be provided at the office of the plan administrator.

Recommendation #14

Marriage breakdown should be treated as a pension event like termination – the member’s benefit should be valued and distributed to the ex-spouse at the time of marriage breakdown.

Section 51 of the PBA which addresses the issue of payment on marriage breakdown causes major problems for all involved: member, ex-spouse, their lawyers (who often do not understand pension plans or the PBA) and plan administrators. The fact that the payment can only be made when the member actually terminates, retires or reaches age 65 unnecessarily ties together two individuals who clearly would prefer to be apart.

The complexity and rigidity of the PBA frustrates both the member and their ex-spouse during an emotionally challenging time when they need easy solutions and not roadblocks put in front of them. The legal and actuarial professions have tended to analyze resolutions to this issue from a theoretical and not a human perspective. The plan administrator is the agent who is most knowledgeable and available to the member and needs to be given the tools to provide practical and timely solutions.

The PBA further complicates matters by enshrining the spouse at time of retirement as the recipient of the survivor pension and provides nothing to the subsequent spouse.

For purposes of equity and simplicity, we recommend that marriage breakdown be treated as a pension event just like termination, retirement, and pre-retirement and post-retirement death and that the member’s benefit be valued and distributed to the ex-spouse at the time of marriage breakdown.

Specifically, this would involve the following:

a) Marriage breakdown as an active member.

The member would be deemed to have terminated as at the date of marriage breakdown and the commuted value of the termination benefit would be calculated.

The commuted value would be multiplied by the years of pensionable service while married and divided by the total years of pensionable service. This amount would be split between the parties as they agreed subject to a maximum of 50% and paid to the ex-spouse. The ex-spouse would be permitted a commuted value transfer to a non-locked in RRSP or an immediate single life pension from the pension plan based upon the ex-spouse's current age.

The member would have their pension readjusted by reducing the amount of pensionable service by the value of the accrued pension paid out. (To protect the member's eligibility for early retirement, the reduction in pensionable service would only apply to the formula used to calculate the member's lifetime pension and any bridge benefit.)

Example:

a) Marriage breakdown occurs when Member is age 48 with 20 years of pensionable service. Spouse is age 50 and they were married for 15 years.

Accrued pension at marriage breakdown is \$2,000 per month with a commuted value of \$350,000. The amount to be split is $15/20 \times \$350,000 = \$262,500$. The spouse would receive now up to 50% of \$262,500 or \$131,250 either as a lump sum or converted to an immediate pension, for example, \$375 a month for life ceasing upon the spouse's death. The plan would have the choice of paying this \$375.00 pension out of the plan or moving the payment to an insurance company.

b) Marriage breakdown as a deferred member.

The deferred pension would be valued as of the date of marriage breakdown and would be split on the same basis as in a) above except the period of time from date of termination to date of marriage breakdown would be excluded from any calculation. Again the ex-spouse would be entitled to a commuted value payout or immediate pension.

c) Marriage breakdown as a pensioner

As the pension is now in payment, the ex-spouse would receive either a pro rata share for the life of the ex-spouse of the immediate lifetime pension in payment (and any bridge benefit until it ceases to be paid to the member) or a transfer of their pro rata share of the commuted value of the pension currently in payment.

Pension plans would be permitted to provide a survivor pension to a subsequent spouse of the pensioner based upon the pensioner's residual pension.

These provisions would greatly simplify a complicated issue for members and their ex-spouses during an emotionally challenging time in their lives. These provisions are practical, equitable and recognize the dynamic nature of relationships in today's society.

d) While relatively few members go through the event of splitting a plan member's pension entitlement, it causes a disproportionate amount of administrative effort and external costs on behalf of the plan administrator. In order that other members are not disadvantaged, we recommend that pension plans be permitted to charge each party a fee to cover costs.

We suggest that the commuted value paid out to each party be reduced by \$500 or the pension paid be reduced by \$50 a month for 10 months. As well, all third party professional fees (e.g. actuary, auditor, lawyer) incurred by the plan should be charged to the parties.

Recommendation #15

The Annual Information Return should be combined with the investment report so that one report is filed with FSCO.

The regulator has recently expanded the scope of audit and information required for investments. While we have no quarrel with this, we are concerned that it is a separate report from the Annual Information Return (AIR). We suggest that the regulatory process would be better served if the investment report were combined with the AIR so that one report is filed as opposed to two separate reports.

Recommendation #16

FSCO should significantly improve the skill levels of those auditing the investment and funding aspects of pension plans so that they could provide informed advice and feedback to plan sponsors.

The same suggestion also applies to examiners sent to review non-investment issues of plans' operations.

Recommendation #17

Pensions payable to deferred pensioners who do not come forward by their normal retirement age should be reduced by the administrative costs incurred to locate the pensioner.

Plans have deferred pensioners on their books who do not come forward by their normal retirement age to collect their pension. Plans may go through major administrative efforts to find these deferred pensioners or must keep them on their books forever or both. Any pension payable to such deferred pensioner should be reduced by the administrative costs incurred by the plan to locate the deferred pensioner and the plan should be able to remove from liability determination all beneficiaries who remain unclaimed as of the maximum accrual age under the Income Tax Act with the caveat that if they come forward afterwards that the benefit be paid retroactive to age 65 without interest.

Recommendation #18

Plan members with service in more than one province should have all of their entitlements based on the jurisdiction where membership terminated.

Ontario currently uses what is called the “checkerboard” approach in that each province’s provisions apply to service rendered in that province. This approach by Ontario is out of step with the rest of the country and we expect is unenforced and unenforceable.

Recommendation #19

DB pension sponsors should be able to file the valuation used to determine pension expense in their audited financial statements rather than the funding valuation.

The Canadian Institute of Chartered Accountants (CICA) first introduced the requirement for pension expense valuations in the late 1980’s. Since then, the pension expense valuation has become the most important of the three valuations (pension expense, solvency, funding) because it impacts earnings per share and share prices. The other (regulatory) valuations have a lesser impact – mainly on cash flow.

Soon plan sponsors will be subject to more stringent disclosure on corporate financial statements of DB pension plans. The existence of three actuarial valuations is confusing both to members and sponsors. Eliminating one valuation would remove another administrative impediment against DB plans and simplify understanding. Benefit security would still be maintained as plan sponsors would still have to file a solvency valuation.

While those involved in the pension industry often relate more to funding and solvency valuations, the reality is that financial decisions and financial statement reporting are based on pension expense valuations and these decisions are made by senior finance (and not HR) staff.

Recommendation #20

Plan sponsors should be able to terminate members from the pension plan if members have not made a contribution for 24 months.

Section 38 permits the member to elect to terminate membership after 24 months where no contributions have been made. The section needs to be amended to allow plan administrators to terminate the member from the plan using the same criteria.

Record keeping and timely submission of termination notices is a challenge for both MEPP's and part-time employees. Often, employers do not formally terminate part-time employees either from employment or from the pension plan – these part-time employees just stop showing up for work. In order to ensure these employees receive their pension entitlements, plan administrators should be allowed to terminate their membership if no contributions have been made by the member or employer for 24 months.

Recommendation #21

Pension plans should have access to the provincial government death registry to ensure the accuracy of their beneficiaries list.

One of the ongoing monitoring efforts that pension plans should undertake on a regular basis is to verify that the right people are receiving payments. We conducted an audit three years ago and uncovered about \$50,000 of annual payments in error. This was a fruitful exercise, but very time consuming. As survivors of deceased pensioners do not always notify the plan administrator, it would be useful and more cost efficient if pension plans could have access to the provincial government death registry. Deaths are a public matter in any event as reported in obituaries. This access is currently denied to virtually all pension plans. Removing this governmental restriction would improve the accuracy of ensuring the proper amount is paid to the proper recipient and will result as well in more efficient service such as less retroactive recovery of overpayments to survivors of pensioners.

Recommendation #22

Trust law should not be applied to pension plan governance issues. A new legal model should be explored that would better reflect the complexities, interrelationships and dynamic nature of pension plans.

Trust law impacts the governance of pension plans and results in less than optimal decision-making. Trust law has been used as the refuge in many court decisions regarding surplus ownership or disposition. While the law may be correct, the consequence is that plan sponsors move out of DB plans because courts award surplus ownership to plan members while mandating that plan sponsors own the deficits.

Trustee Qualifications

Recommendation #23

The PBA should mandate that trustees should have a minimum level of skills or related experience. The level of skills should either be acquired before a trustee is appointed or at least a meaningful component must be obtained during the first term of appointment.

Section 8(1), (b), (c) and (e) should specify a minimum set of skills, competencies and experience for members of pension committees and boards of trustees, both employer and employee appointees.

These committees or boards are responsible for the stewardship of billions of dollars of retirement wealth. In order to properly discharge their duties, the level of skills needs to be enhanced and this can only be done through legislation/regulations.

The minimum level of skills could include professional designations in the following professions: actuaries (FCIA), lawyers (LLB), investment professionals (CFA) and accountants (CA, CGA, CMA). They could also include pension related certification from industry bodies or post secondary colleges and universities. Examples include the CEBS designation from the International Foundation of Employee Benefit Plans or the CEB, PPAC and/or PFIC certifications from the Humber College Employee Benefit Centre.

Related industry experience could encompass experience in human resources, pension, investment or accounting functions.

Ideally, all trustees should have the required certification or professional designation before they are appointed. In reality, as many will not, new appointees will be allowed to obtain the required skills or designation during their first term, but will not be eligible for reappointment unless they have acquired all or a meaningful part of the appropriate skills or designation.

Income Tax Amendments

Recommendation #24

The Ontario government should urge the federal government to amend the Income Tax Act to i) increase the surplus limit from 10% to 50%, ii) increase the maximum pension accrual from \$2,222.22 per year of service to \$5,000, and iii) increase the money purchase amount to \$45,000 based on the factor of 9 currently used to determine the relationship between DB and DC maximum entitlements.

While these recommendations are outside the authority of the Province of Ontario, the provisions in question negatively impact DB plans and discourage the establishment of new ones. The province should urge the federal government to amend the Income Tax Act accordingly.

- a) The 10% surplus threshold is too low and does not provide enough cushion when investment returns plummet, or liabilities increase due to decreases in interest rates, or both, as happened following the collapse of the tech bubble in 2000.

The high investment returns of the late 1990's coupled with higher interest rates then compared to now put many DB plans above the 10% surplus limit. As a result, these plans implemented contribution limits and/or benefit improvements to get below the 10% limit.

Then, following the market collapse in 2000-2002 and the decrease in interest rates, these same plans experienced major decreases in their funding position – from surplus to deficits, sometimes massive, resulting in increases in plan sponsor contribution rates. A greater surplus cushion would have prevented this swing. This volatility from contribution holidays or decreases to extra contributions to cover deficiencies plus normal cost contributions makes corporate cash flows unpredictable. This is a major disincentive for a private sector employer to establish or continue with a DB plan. The change would also provide a less volatile and steadier flow of tax revenue to federal and provincial governments.

- b) When the maximum annual pension limit was last meaningfully increased to \$1,715 per year of service in 1976, the 2% benefit formula covered salaries up to 7 times the average wage. In today's terms that would be \$306,000 (7 x \$43,700 – 2007 YMPE, proxy for average salary).

The 2% benefit formula would result in a pension of \$6,120 per year of service. To make Canada more competitive with other countries (particularly the U.S. and U.K. where the limits are \$4,737 and \$4,566 respectively) a limit less than the formula derived number of \$6,120 would be required. We recommend \$5,000. We suggest this would have only a minor impact on tax revenues because many of the plan members affected by the current limit are covered by funded or unfunded executive pension plans where a tax deduction is received either when the

contribution is paid in or the benefit is paid out. In fact, we suggest that over time tax revenues would increase because total pension contributions would be less due to more of the investment income being tax sheltered.

- c) When the Pension Adjustment regime was put in place, the spoken intent was to provide a level playing field for all types of retirement savings. Based on a DB limit of \$5,000, the corresponding DC and RRSP limits would be \$45,000 and \$44,000 respectively.

Indexation

Recommendation #25

Sponsors should be permitted to curtail future increases arising out of guaranteed indexation for existing pensioners where a plan has a solvency deficiency.

Currently, employers and, in some cases, active members bear the brunt for funding the deficit and retired members are off the hook. For purposes of equity, where a solvency deficiency exists and where benefits can be reduced, sponsors should be permitted to curtail future increases arising out of guaranteed indexation for existing pensioners.

This action may give rise to the claim of adverse amendments. The issue of adverse amendments can be highly subjective in terms of interpretation. We recommend that this Section 26 of the PBA be expanded to expressly state that changes in optional forms of benefits, early retirement eligibility and reduction factors and indexation payable in the future not be considered as adverse or as a reduction in accrued entitlement because the event has not yet occurred.

Investment Regulations

Recommendation #26

The regulations governing pension plan investments should be modified to remove a number of maximum limits:

- i) 10% investment in any non government entity**
- ii) 5% -15% - 25% limits on resource property and real estate investments**
- iii) 30% limit on the voting shares of a corporation**

These rules are holdovers from the old “legal-for-life” regulatory environment and do not fit in with the prudent portfolio approach (as contained in the Federal Investment Regulations) that applies to the PBA. These rules were written when pension plan investments and the investment industry were much simpler – the environment was a “long” only space and anything other than bonds, blue chip stocks, mortgages and treasury bills was considered risky. These constraints have no place in today’s market and should be abolished as part of the prudent portfolio concept. The 30 percent limit on voting shares has not proven to be much of a constraint as various pension plans have found a way around this limitation. In addition, a rationale as to why this rule was ever introduced in the first place does not appear to exist. It should be removed.

Recommendation #27

Employers should have the right to provide a DC plan to part-time employees in place of the DB plan offered to full-time employees subject to the requirement that the employer contribution to the DC plan is the same as the current service cost to the employer for benefits accrued in the current year for full-time employees.

Coverage of part-time employees in a DB plan that covers full-time employees often presents administrative challenges to plan sponsors and serves as a deterrent to establishing DB plans. Employers should have the right to provide a DC plan to part-time employees in place of the DB plan offered to full-time employees subject to the requirement that the employer contribution to the DC plan is the same as the current service cost to the employer for benefits accrued in the current year for full-time employees. This would greatly simplify administration and would remove an impediment against establishing a DB plan.

When the PBA was implemented in 1988, Section 34 contemplated provision of a separate plan for part-time employees. FSCO took a strict interpretation of that section and did not permit a separate DC plan for part-time employees. Removing this impediment would encourage the establishment or continuation of DB plans for full-time employees.

The focus of this change would be single employers in the private sector. Multi-employer boards of trustees or jointly-sponsored pension plans would only be able to implement or change to a DC plan for part-time employees if their governing bodies so authorized.

5. RESPONSES TO QUESTIONS RAISED IN DISCUSSION PAPER

GENERAL QUESTIONS

1.1 To what extent do occupational pension plans – especially defined benefit plans – contribute to the overall provision of income security for Ontario’s older workers?

They are key. If we accept that the average wage in Ontario approximates the YMPE of \$43,700 and a commonly accepted post-retirement income target of 70% of pre-retirement salary, then the average pensioner needs a retirement income of about \$30,600. CPP and OAS provide about \$16,300 leaving a gap of \$14,300 or 33% of pre-retirement salary. Pension plans are the ideal vehicle to fill this gap, particularly DB plans. In this example, a simple DB plan of 1% of final average salary would provide the career employee (assume 35 years) with a pension sufficient to cover the gap. RRSPs are a useful vehicle, but statistics continue to confirm that most employees do not contribute at the maximum that they are permitted, particularly lower paid employees who are less likely to be covered by a pension plan. In summary, expanding coverage of pension plans particularly DB plans is vital to provide the required post retirement income for working Ontarians.

1.2 To what extent do these plans presently meet the needs and expectations of their members and sponsors?

Where DB plans are in place, as a rule they meet the income replacement objectives. The problems are:

1. where employees are only covered by a DC plan, the contributions are generally not at the level needed to produce the target post retirement income and the member takes all the investment risk, and
2. where employees have no pension coverage at all.

1.3 How well have these plans been managed in recent years, and how might their management be improved?

For plans managed by joint Boards of Trustees, there is a potential trade off in that representation of various constituencies is being achieved at the cost of professional competencies. Investment returns and the quality of investment decisions may be less than optimal. For single employer plans, the issue is less one of management and more the lack of balance between ownership of surplus and deficits.

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

The combination of restrictive legislation, both the Ontario PBA and the federal Income Tax Act (ITA), and court decisions that go against single-employer DB plans, have resulted in a decrease in DB plans and a reluctance to create new ones.

Examples:

- Grow-in provisions (PBA)
- Surplus ownership (PBA and Courts)
- Surplus distribution on partial plan wind-up (PBA)
- Low surplus funding limits (ITA)
- Artificially high Pension Adjustments for private sector DB plans (ITA)

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?

Members and pensioners are well protected, but at a cost to employers. There is no incentive for employers to set up or continue with a DB plan.

1.6 Are appropriate oversight mechanisms available to ensure compliance with the legal rules?

Generally, yes. However, the regulators do not have enough trained resources to properly monitor pension plan activities.

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

We already have that, but the rules need to be clarified to deal with all the aspects of DB, DC, MEPPs and JSPPs.

1.8 How much importance should be attached to the harmonization with the law of other Canadian jurisdictions?

This is an ideal, but practically speaking may never happen as no province will surrender jurisdiction to a national or federal entity. The best we can hope for is that the province of registration applies to all aspects of a pension plan regardless of where the employee is resident.

1.9 What are the overall effects of the present system of occupational pension plans on Ontario's social policies and economy?

The present system of occupational pension plans provides a key element of post retirement income support, but improvement in legislation would lower or smooth funding costs and could decrease costs paid to outside legal, actuarial and investment service providers leaving more money to pay for benefits.

Effect of Changing Social and Economic Environment

2.1. How have long-term changes in the structure of Ontario's economy, in its labour market and social welfare policies, and in patterns of employment, unionization and compensation affected occupational pension plans?

Employees in the private sector do not spend a career with the same employer, thus frustrating the objective of building up an adequate post-retirement income. Even if they are fortunate enough to belong to a DB plan at each stage of employment, the income produced from a series of DB plans will generally be a lot less than the pension produced from one plan where they spent their entire career.

The other main change is the increase in the number and proportion of part-time employees relative to full-time employees. Part-time employees are less likely to be covered by a pension plan and the administrative burden of enrolling and terminating a number of part-time employees is more than the effort required for the equivalent number of full-time employees.

2.2. How will longer life expectancies and the end of mandatory retirement affect such plans?

Longer life expectancies will increase costs for DB plans because the plan assumes the risk and cost of mortality. Removal of mandatory retirement will result in a minor reduction in costs for those who would have otherwise retired at age 65. A larger number and proportion of older employees will be working after 65 because they want to or have to and employers will need them to deal with the coming labour shortages.

2.3. Is the ratio of retirees to active members of occupational pension plans changing and, if so, why? What are the effects of such changes on these plans?

Yes, because of demographics and the “baby boomer” bulge and a shortage of workers behind them. The effects on the funding of DB plans should be negligible because the benefits are funded as they are earned. The impact of fewer active members will be in smaller cash flows into a DB plan. This may also spur smaller plans to join together to form “Multi - Employer Pension Plans”. As retirees increase, the pensions paid will increase and the cash flow will be negative and will need to be supported by more investment income.

2.4. How have recent fluctuations in investment returns and long-term interest rates affected defined benefit plans in particular?

The visibility has been to the investment returns, particularly the negative returns in 2001 and 2002 as well as the “corrections” we have experienced in Q3 of 2007. The key factor, however, has been the decline in long-term interest rates. In spite of high positive investment returns, funding levels have decreased due to the impact of decreasing long bond rates.

2.5. Are such fluctuations likely to accelerate or decelerate in the future? Can new tendencies be identified that might affect these plans positively or negatively?

We have no way of assuming or predicting that volatility in investment returns will be any less in the future than in the recent past. Concerning interest rates, we must assume that we are in a long-term low interest rate environment. This will have elements of volatility, but assuming low interest rates is more prudent from a funding perspective as higher interest rates will represent an experience gain for most plans.

2.6 How might changes in the viability, coverage, cost and funded status of occupational pension plans affect the prosperity, security and well-being of Ontario workers and pensioners?

Increases in cost and decreases in funded status will adversely affect the viability of DB plans resulting in decreased coverage. The economic well being of Ontario workers and pensioners will deteriorate.

2.7 What has been the impact of inflation on pensioners and pension plans? How common is the indexation of pension benefits?

High inflation (as was the case in the 1970’s) was ruinous for pensioners. Low inflation is desirable, but, over time, still erodes the purchasing power of retirees’ income. Indexation is common in public sector plans but rare in private sector plans, which provide or may provide occasional adjustments. It is somewhat bizarre that the focus has been on indexation for DB plans, while no mention is made of the impact of inflation for those with DC pensions.

2.8 How does the health of occupational pension plans affect the robustness of the Ontario economy and the success of Ontario businesses? How might their health affect different workplace constituencies such as public and private sector employers, large and small enterprises and unionized and non-unionized workforces with different demographic profiles located in various work settings?

Well funded pension plans are the ideal both for private sector plans and the impact on corporate financial statements, and public sector plans and the impact on government expenditures and ultimately tax policies.

2.9 Are changes in the structure and governance of occupational pension plans likely to affect their administration and financial well-being, and if so, how?

Yes, improving the competencies and skill levels of the decision makers should result in better investment decisions with a greater long-term focus and avoid reckless increases in liabilities when there is a desire to “use up the surplus”.

Innovation and constraints in pension policy-making

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?

They are currently, and should remain, the key element in the provision of a secure retirement income.

3.2 Will these strategies, in combination, provide all retired Ontarians with a measure of equity and security?

Yes, but only if they are covered by a pension plan. Security will be materially enhanced with DB plans compared to DC.

3.3 What can be done to strengthen the role of occupational pension plans in the short term? In the longer term?

The imbalance between ownership of surplus and responsibility for funding deficiencies should be removed. Private sector DB plans will only thrive if the volatility in pension expense reporting is reduced.

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?

The PBA as a generalization, is written based on the assumption that most pension plans are of the traditional DB type with a uniform accrual rate of benefits, and reflect what is standard in the public sector pension environment. Flexibility should be allowed in design, such as cash balance or lump sum accruals based on multiples of salary. While these do not have the security of traditional DB plans in pooling investment and mortality risk, they do provide a model in risk sharing – the plan taking the investment risk and the member taking mortality risk.

We can see advantages of offering larger pooled pension vehicles based on industry type or geography but do not know if they should mandate coverage at this stage. Larger plans should be more efficient and be able to operate at lower unit costs than smaller plans.

The role, risk and attractions of defined benefit pension plans

4.1 What are the unique attractions of defined benefit plans? What special problems are associated with them?

DB plans provide a secure benefit and pool investment and mortality risks. They provide efficiencies and economies of scale relative to DC plans in that DB costs are more of a wholesale nature compared to DC costs which are more of a retail (higher cost) nature.

The problems with DB plans are that, aside from the asymmetry issue relating to surplus and deficits, they are better designed for career employees than the mobile work force that is now more of the norm, certainly in the private sector. By design, they benefit certain groups compared to others (older vs younger). Another problem is that they are dynamic and long-term in nature whereas certain players want to freeze them at a point in time and, for example, crystallize surplus in an otherwise ongoing plan for purposes of benefiting a certain group, e.g. employees who are part of a partial plan wind-up.

We would suggest that the DB model have another component which is more analogous to the traditional MEPP which would characterize the plan as a “target benefit” as opposed to a “defined benefit” in that benefits would be reduced if the plan is not fully funded.

4.2 Will fluctuations in unionization rates and in levels of public-sector employment affect the extent of their coverage and their financial viability in general and in different plans?

Under the current regime, as unionization rates and public sector employment go down, coverage will decrease. This presupposes that there is no increase in private sector coverage where no pension plan exists now.

4.3 What is the effect of employer business strategies on the form of pension provision? What is the impact of privatization, mergers, acquisitions and bankruptcies on defined benefit plans?

None of these events are conducive to maintaining existing DB plans or starting new ones as the focus is on cutting costs (and staff) as a way to finance the acquisition or merger.

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 their wider adoption?

The central theme of this submission is that DB plans should be promoted and protected, particularly in the private sector, and we have presented a number of recommendations as to how this objective can be achieved.

4.5 Should indexation of defined benefit plans to offset inflation be left to the discretion of the plan sponsor, subject to collective bargaining in the case of unionized workplaces?

Indexation should not be mandated. We don't even know if it should be offered as an optional form of pension. It should be a decision of the plan sponsor(s) or left as a subject for negotiation subject to constraints on increasing liabilities when a plan is already in a deficit position.

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?

We have answered this in 3.4. Target benefit, cash balance plans and defined multiples of

salary payable as a lump sum should all be permissible. The traditional DB plan has many advantages, but other forms should be available as a way to encourage increases in coverage.

4.7 Should Ontario compile and publish materials that might enable members and sponsors to make more informed choices among different types of plan design and strategy?

Yes, but we question if this should be a priority. Of more importance is educating members of DC plans about investment risk and strategy.

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?

Outside of the public sector and traditional MEPPs, we doubt that joint administration would entice many employers to establish DB plans. A thorough and objective analysis of the impact of pension committees as they have operated in Quebec needs to be done before joint administration is examined in detail as a way to improve the administration and quality of decisions of DB plans. Joint administration does not necessarily provide enhanced quality of investment and strategic decisions, it just provides lay, sometimes unqualified, representation for members.

Underfunding and overfunding

5.1. Are existing definitions of plan “solvency” realistic?

They may be “realistic”, but they are inappropriate and, as they currently exist, are a disincentive towards establishing or keeping a DB plan. However, they are only part of a bigger picture which must include surplus and deficit ownership and the restrictive surplus funding limits under the Income Tax Act. These issues are one of the most serious impediments facing DB plans. The five year provision to fund solvency deficits should be increased to 15 years along with increasing the ITA funded status limits to 150%.

5.2. Are the consequences of over or underfunding for employers, workers and pensioners fair, clearly stipulated, well understood and appropriately enforced?

The consequences are neither fair nor well understood. They may be clearly stipulated, but that is irrelevant if they are not well understood by the parties. We cannot comment on the degree of enforcement.

5.3. Is there a necessary connection between underfunding and overfunding? If so, what does that connection mean for how the rules should address both situations?

The combination of accounting rules, the PBA (surplus ownership) and ITA (funding limits) lead to high volatility in contribution rates from solvency deficits to contribution holidays. This volatility would be eliminated with a 15 year amortization period and a 150% funding threshold. In addition to the above, the lack of balance on surplus ownership leads private sector sponsors to make contributions at the minimum level possible.

5.4. Should the pension regulator have wider powers to address funding concerns? If so, should these be discretionary powers?

Yes, but only in concert with all the changes previously discussed being implemented. Ideally, these powers should be discretionary, but that may leave FSCO open to criticism about lack of consistency. To protect the regulator, more analysis would need to be done on this subject before a decision is made. Also, an extension of powers would have to be accompanied by staffing that was skilled and knowledgeable.

5.5. Should different rules apply to different kinds of plans and different kinds of employers? If so, what distinctions would be appropriate and why?

We have commented on this at length. Briefly, solvency funding time limits should be increased to 15 years and JSPPs should be excluded from funding solvency deficits.

5.6. Should relief be provided against present solvency funding requirements, and if so, to which types of pension plans, in which sectors, and under what conditions?

See 5.5 above.

5.7. Should the sponsoring employer's financial strength be taken into account? And if so, to what extent and by what means?

We don't know how this should be done. Our main concern is underfunded plans increasing benefits before or while the plan sponsor is experiencing their own financial pressures.

5.8. What types of measures might be made available to employers to enable them to deal with funding deficiencies that seem likely to be short term?

The popular answer or remedy adopted in some jurisdictions is to use of letters of credit. We think this is a useful tool that should be explored. We have a concern that letters of credit are

only available if the plan sponsor is financially solvent and the real need is to ensure proper funding of plans when the plan sponsor is experiencing financial difficulties.

Ensuring solvency in a volatile economy

6.1 Should Ontario urge the federal government to amend the *Income Tax Act* to allow plan sponsors to make extra contributions to the plan from time to time to keep it solvent over the long term?

Absolutely. We recommend the funding level limit under the ITA be increased from 110% to 150%.

6.2 Should plan sponsors be given greater latitude to increase contributions or reduce benefits under carefully specified conditions?

Probably. See recommendations made elsewhere.

6.3 Should public policy encourage some other approach to the possible loss of plan solvency, such as mandating the establishment of earmarked contingency reserves?

We are not in a position to state if this is or is not desirable.

6.4 If a plan sponsor decides to pursue riskier investment strategies to deal with solvency concerns, should this decision be required to be taken according to some special procedures, or made subject to more intensive oversight?

Yes to both questions. The strategies must be clearly permitted under the Statement of Investment Policies and Procedures (SIPP) and the plan should have an articulated funding and risk tolerance policy. The danger with this strategy is that excessive risk will be taken in the hope of “hitting a home run” to eliminate a deficit and the risk increases as the deficit increases. More oversight from both the external auditor and FSCO should be applied relative to the plan sponsor who undertakes such a strategy.

6.5 What effect might changes in the investment strategies of pension plans, and in the rules governing investment strategies, have on capital markets in Ontario?

In general, we believe the changes will be limited as most pension investment is in the secondary market. The major impact will be from those plans that purchase Initial Public Offerings or participate in private equity purchases.

The Pension Benefits Guarantee Fund

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?

In our submission, we have commented on this subject at length. In summary, guarantee funds work better in theory than practice as they penalize the prudent sponsor and can benefit the reckless sponsor. We have recommended that the PBGF be terminated.

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?

We doubt it. See 7.1

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 underfunding or the employer's insolvency? If not, what are the alternatives?

No. See 7.1 above. The alternatives are a better and clearer sharing of risks and rewards between plan sponsors and members and changes to improve funding and increase funding cushions.

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?

As the PBGF should be wound up over a brief period of time, oversight could remain with FSCO during the phasing out period.

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

We have commented on these linkages extensively in the body of our submission.

Significant changes to pension plans as a result of changes in the employment relationship: Wind-ups, splits, mergers and insolvencies

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

While accrued entitlements must be protected, there should be more flexibility permitted in the PBA to allow surplus funds to be used to finance future plan sponsor contributions whether to the same DB plan, a different DB plan or a DC plan. Recent court decisions (Kerry and Sutherland) have sanctioned a greater flexibility in these situations and this should be recognized in the PBA.

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?

The answers to the three questions are “probably not”, “probably yes”, and “definitely yes”. From a conceptual perspective, the PBA should specify a default approach unless the plan text provides something different.

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?

Yes, but under clearly defined circumstances. At the same time, the regulator needs to have the power to act quickly and with discretion once the clearly defined circumstances have been satisfied.

8.4 Should the PBA be amended to more specifically deal with pension plan mergers?

Yes. The objective is to promote continuation of existing plans and expand coverage. See also our comments under 8.1. Surplus in a merged plan can be used to cover future contributions, whether DB or DC. What needs to be protected is the promised benefit accrued to the date of mergers. Members were promised and entitled to a defined benefit, not a defined surplus.

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 surplus and the preservation of “grow-in” rights in the event of partial wind-ups?

The key concern is distribution of surplus on a partial plan wind-up, not the partial plan wind-up itself. We have already provided our recommendations on the application of grow-in. Further

analysis would need to be done to see if partial plan wind-ups should be eliminated entirely.

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 best approach is establishing a legislative and regulatory environment that promotes the continuation of pension plans. Rules designed to protect members often result in protecting a shrinking pie rather than increasing the size of the total past and future pie.

Regulating the pension system

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?

We have suggested changes previously: 1. Ontario should cease adhering to the “checkerboard” approach in application of jurisdiction to service; 2. Obtain agreement that the PBA of the jurisdiction of registration applies in all aspects for pension plan members regardless of province of domicile. This leads us to answer that existing interprovincial arrangements should be strengthened as suggested above.

9.2 Should an effort be made to clarify and codify the law governing pension plan funding in Ontario? If so, should the PBA be amended to encompass matters new dealt with by the general law?

Yes, probably, to both questions.

9.3 Should an effort be made to ensure that pension plan sponsors and beneficiaries are better acquainted with their rights and obligations?

Probably yes, but this is not a priority until other substantive changes have been made to the PBA.

9.4 Are the powers and staff resources of FSCO, the FST and the Superintendent of Financial Services adequate to perform the tasks presently assigned to them, and would the assignment of further responsibilities require additional powers and resources?

We are not in a position to comment on the powers and adjudication structure itself. Concerning the staffing level at FSCO, we are of the firm view that there is a shortage in the number of staff resources at FSCO’s disposal and that there needs to be more training provided to them so they have the skills they need to operate in a dynamic regulatory environment. This

is particularly the case as FSCO expands its efforts in analysis and monitoring of risk and investment strategies. We recognize this will result in an increase in fees assessed plans, but feel this is more efficient in the long run as the cost of a failed plan is often far in excess of the higher fees charged that prevent a calamity from occurring.

9.5 Should some of these tasks be reassigned to other bodies, such as the courts, or discontinued altogether?

We are not in a position to comment on the appropriate course of action. From a high level perspective, we have a view that many pension issues are in the area of administrative law and issues are better dealt with where the level of expertise resides. This means that greater power and deference should be given to the regulator as opposed to the courts. While we don't know the answer in terms of detail, from a general perspective:

- there should be no reassignment to the courts and away from FSCO;
- the role, scope and authority of FSCO should be strengthened; and
- there are probably some tasks that can be discontinued, but we cannot identify any at this stage.

9.6 What is an appropriate regulatory role for expert and professional bodies in the Ontario pension system?

While there is a role for expert and professional bodies in the Ontario pension system, we feel that the actuarial profession in particular is given too much leeway in determining certain entitlements such as commuted values. The danger of allowing the standards to be determined by such a body is that there is no mechanism to ensure the standards are current and meet the needs of members and plan sponsors. We suggest the regulator and legislation adopt an approach of considering the advice and opinion of such bodies in the formulation and development of regulations and regulatory policy as opposed to allowing such bodies to determine the policy at hand.