PROMISES TO KEEP

Pension Review Panel

JANUARY 27, 2009

NOVA SCOTIA

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Introduction

Our panel was commissioned a little over a year ago. Many issues required responses to bring the regulatory framework up to date and to replace some temporary patches that had been enacted in response to particular situations. The financial turmoil of the last six months has emphasized both the importance of our task and the urgency of a response.

Our work has benefited from many sources of support. We received dozens of responses both to our preliminary discussion paper and to our draft proposals. These were supplemented by fruitful discussions with advocates from all sectors. The panel has worked hard to understand these points of view and to consider individual situations. But our paramount goal has always been that promises made to members of pension plans should be kept.

We are indebted to all those who have provided input. We especially want to thank local members of the pension actuarial community who have given generously of their time to help us think about important funding issues. We have also benefited from the chance to talk with panelists from other provinces and to read their reports. Rachel Henderson from the Department of Labour and Workforce Development has been our resource person and has done much of the heavy lifting, including authorship of much of the draft material.

Our topic is unavoidably complex. We have sought to keep this report at a high level so that the key themes remain clearly visible to non-expert readers. At the same time we have needed to be quite specific on certain issues so that the impact of our proposals could be tested.

The themes are funding, flexibility, and governance. Funding of plans must be sufficient to fulfill all promises. The required funding levels must deal openly and realistically with market circumstances, while somewhat constraining volatility. Flexibility in regulation will be needed to accommodate evolving benefit designs and forms of oversight. Governance must be effective and transparent; participation of members is to be strongly encouraged.

We strongly urge government to put in place a process that will result in a legislative response during 2009. The existing framework is not appropriate to today's circumstances. Left unchanged it will create considerable difficulty for pension plans, their sponsors, and their members.

Ron Pink
Dick Crawford
Bill Black
January, 2009

Background

A number of legislative and societal changes have taken place in recent years. Labour shortages have increased; people change careers more often; there are growing succession concerns; and the youth population is decreasing. The federal government has passed legislation allowing phased retirement for federally regulated employees and the mandatory retirement age of 65 will end in Nova Scotia in July 2009, allowing Nova Scotians to continue working if they choose.

The economy has changed significantly since the Panel began its work. Pension funds have suffered from adverse markets - there has been a 35% decline in the TSX composite index in 2008. The mandate of this Panel was to recommend lasting solutions for pension legislation and regulation. But given the change in the world's economic fortunes, the Panel has also turned its mind to the current situation and has provided interim pension recommendations that consider the current economic crisis.

Mandate and Composition

Given the numerous changes, the fact that the last public consultation on pensions was in 1998, and the decline in participation rates in pension plans, the Nova Scotia government announced in November 2007 that it would be creating an advisory panel to review the current pension legislative framework. As a result of this announcement, an independent Pension Review Panel was created in February 2008.

The Pension Review Panel's Terms of Reference enumerated the following key objectives for the review:

(1) To recognize current legislative standards and review improvements that will allow pensions to work for both employers and employees;

(2) To enhance the affordability and availability of Defined Contribution and Defined Benefit pension plans for employers and employees;

(3) To protect the sustainability and security of pension benefits;

(4) To enhance the sharing of information to plan members;

(5) To eliminate unnecessary rules and regulations.

The review included consultation with the pension management industry, actuaries, unions, employers, and retirees. The Panel was tasked with making recommendations for potential changes to Nova Scotia's pension legislation.

The Panel included Bill Black, former President and Chief Executive Officer of Maritime Life as Chair of the Panel, Ron Pink, an experienced labour lawyer, and Dick Crawford, a former president of the Canadian Institute of Actuaries.

Review Process

We began with a Discussion Paper, outlining the topics for discussion and seeking input on the issues.

The Panel received 51 written submissions in response. The Panel invited some of the stakeholders to meetings to further understand the issues and views raised.

The Panel was impressed by the quantity and quality of responses received from stakeholders, both in written form and during consultation meetings. Stakeholders' interest and input encouraged the Panel to extend stakeholder involvement in the review. We determined that there would be substantial value in releasing an Interim Position Paper to seek feedback on the Panel's tentative answers to the questions posed by the Discussion Paper. In response, the Panel received 42 written submissions. Again, the Panel invited some of the stakeholders to meet with the Panel to further discuss the tentative recommendations and the stakeholders' reactions to them.

While the original Terms of Reference of the Panel indicated that the Final Report would be released in late 2008, the decision to issue the Interim Position Paper pushed back the release of the final Report to January 2009. However, the invaluable information the Panel obtained through its second round of consultations was well worth delaying the Final Report.

The Panel's Papers and Final Report, and all of the written submissions received, are and have been, available to the public on the Panel's website: www.gov.ns.ca/lwd/pensionreview/.

Historical Overview

There are three pillars to Canada's pension system. The first two pillars are publicly managed (1) Old Age Security and the Guaranteed Income Supplement, and (2) the Canada Pension Plan/Quebec Pension Plan. The third pillar consists of Registered Pension Plans and Registered Retirement Savings Plans (RRSPs), which are funded by individuals and, sometimes, their employers. It is this third pillar, and in particular, Registered Pension Plans, which was the subject of this review.

According to Statistics Canada, in 2006, there were 1,427 pension plans covering 169,389 employed paid workers in Nova Scotia. This means that only 38.3% of employed paid workers in Nova Scotia contribute to pension plans. That's down from approximately 45.4% in 1996. Of these plans, 495 were regulated by Nova Scotia. (Statistics Canada: Pension Plans in Canada, 2006).

In 2006, there were about 441,800 employed paid workers in the Nova Scotia labour force. Approximately 272,000 workers in Nova Scotia were not members of pension plans. This includes self-employed workers, as they cannot participate in an occupational pension plan. These workers will, presumably, be relying on RRSPs, personal investments, and/or government sources of retirement income, such as Old Age Security (OAS), the Guaranteed Income Supplement (GIS), and the Canada Pension Plan (CPP). Unemployed Nova Scotians will be relying on those same sources, although their situation may change as they move back into the workplace. In 2006, there were approximately 36,400 unemployed Nova Scotians[1]. Currently, the maximum that a single Canadian, who does not have RRSP or personal investment savings, and who did not pay into CPP during their lifetime, could receive would be $1136.33 per month (maximum OAS plus maximum GIS), which is approximately $13,636.00 per year. This low amount highlights the need for Nova Scotians to save for retirement whenever possible.

The Province understands that the seniors population is rapidly increasing, and there will be increasing long-term pressure on seniors housing and some Community Services programs if there is no encouragement of retirement savings. There are indirect costs to the Province in the provision of support programs for seniors who have reduced income in retirement. A key area of concern is for people between ages 45-65, who, if they lose their employment, have difficulty bridging to retirement if they do not have a pension plan.

In Nova Scotia, a large segment of the workforce who contribute to pension plans are covered by municipal, provincial, federal, military, teachers, university or other publicly funded plans.

As was already mentioned, a number of societal changes have occurred. Generally, unemployment rates have been in decline since 1996, there has been an increased demand for labour, and the youth population is decreasing. In 2007, approximately 17% of people in the NS workforce were over 55, as compared to approximately 10% in 1997.[2] It will be to an employer's advantage to encourage older experienced workers to stay on the job longer. The introduction of phased retirement will make this easier.

The following tables outline Nova Scotian and Canadian pension plan membership and contribution rates, as well as the number of plans and members by the size of the membership groups.

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[1] Statistics Canada, Labour Force Survey, Table 282-0087, Catalogue # 71-001-XIE

[2] Source: Statistics Canada: Labour Force Survey, Catalogue # 71F0004XCB - Labour Force Historical Review 2007

Number of plans and members by Membership-Size Group based on Pension Plans with Members in NS (Reference Period: January 1, 2007)

Membership Size	**Plans (in Canada)**	**Percentage**	**Members (in NS)**	**Percentage**
0				
1	66	4.6%	66	0.04%
2-9	125	8.8%	615	0.4%
10-49	283	19.8%	4,436	2.6%
50-99	164	11.5%	5,533	3.3%
100-499	400	28.0%	20,753	12.3%
500-999	134	9.4%	12,546	7.4%
1,000-4,999	205	14.4%	28,509	16.8%
5,000-9,999	23	1.6%	11,508	6.8%
10,000 -29,999	18	1.3%	60,418	35.7%
30,000+	9	0.6%	25,005	14.8%
TOTAL	**1427**	**100%**	**169,389**	**100%**

Source: Pensions information: Statistics Canada: Pension Plans in Canada, Survey # 2609

Pension Plan Contribution Rates, Amounts ($) and Membership for Nova Scotia and Canada

	1996		2001		2006	
	NS	Canada	NS	Canada	NS	Canada
Employed	376,900	-	415,200	14,946,200	441,800	16,484,300
RRSPs/GRRSPs **# of contributors**	143,950	5,998,430	139,190	6,241,050	132,590	6,196,050
Total Contributions ($)	615,298,000	26,381,304,000	574,546,000	24,438,914,000	634,234,000	32,350,792,000
Defined Benefit **# of members**	132,509	4,453,907	132,236	4,534,941	130,097	4,590,805
Total contributions($)	132,985,135	18,055,895,842	134,854,561	17,798,008, 709	283,640,740	38,237,700,000
# of plans	837	6,901	784	6,289	642	11,056
Total Public plan membership	82,308	2,301,478	82,887	2,361,626	87,014	2,550, 813
Total Private plan membership	50,201	2,152,429	49,349	2,173,315	43,083	2,039,992
Defined Contribution **# of members**	21,769	574,769	29,389	796,088	35,963	899,540
Total Contributions($)	40,994,489	1,288,544,305	72,090,258	2,057,790,641	120,253,548	3,163,380,000
# of plans	671	8,103	732	7,310	720	7,160
Total Public plan membership	5114	99,729	6,013	132,629	6,986	132,124
Total Private plan membership	16,655	475,040	23,376	663,459	28,977	767,416

Source: Pensions information: Statistics Canada: Pension Plans in Canada, Survey # 2609. Please note that data is as of January 1 of each year, so for example, January 1, 2007 data is 2006 in the chart; RRSP information: Statistics Canada: Canada's Retirement Income Programs 2006, Catalogue # 74-507XCB, Table 111-0039; Employment numbers: Statistics Canada: Labour Force Survey, Catalogue # 71F0004XCB; *Please note that hybrid plans are not represented in this chart.*

Nova Scotia Contributors

	1996		2001		2006	
	Employed and % of Employed		Employed and % of Employed		Employed and % of Employed	
Defined Benefit Plan						
Total DB	**132,509**	**(35.2%)**	**132,236**	**(31.8%)**	**130,097**	**(*29.4%*)**
Total Public	*82,308*	*(21.8%)*	*82,887*	*(19.9%)*	*87,014*	*(19.7%)*
Public-regulated in NS	21,938	(5.8%)	25,566	(6.2%)	33,965	(7.7%)
Public-regulated elsewhere	60,370	(16%)	57,321	(13.8%)	53,049	(12.0%)
Total Private	*50,201*	*(13.3%)*	*49,349*	*(11.9%)*	*43,083*	*(9.8%)*
Private-regulated in NS	22,543	(5.98%)	21,297	(5.1%)	18,760	(4.2%)
Private-regulated elsewhere	27,658	(7.3%)	28,052	(6.8%)	24,323	(5.5%)
Defined Contribution Plan						
Total DC	**21,769**	**(5.8%)**	**29,389**	**(7%)**	**35,963**	**(8.1%)**
Total Public	*5,114*	*(1.4%)*	*6,013*	*(1.4%)*	*6,986*	*(1.6%)*
Public-regulated in NS	4,702	(1.2%)	5,397	(1.3%)	5,998	(1.4%)
Public-regulated elsewhere	412	(0.1%)	616	(0.1%)	988	(0.2%)
Total Private	*16,655*	*(4.4%)*	*23,376*	*(5.6%)*	*28,977*	*(6.6%)*
Private-regulated in NS	11,304	(3.0%)	16,343	(3.9%)	21,263	(4.8%)
Private-regulated elsewhere	5,351	(1.4%)	7,033	(1.7%)	7,714	(1.7%)
Other Types of Plans	1704	(0.5%)	1838	(0.4%)	3329	(0.7%)
No Registered Pension Plan	220,918	(58.6%)	251,737	(60.6%)	272,411	(61.7%)
RRSPs/GRRPs	-		139,190	(33.5%)	132,590	(30.0%)

Source: pension information from Statistics Canada: Pension Plans in Canada, Survey # 2609. Please note that data are as of January 1 of each year, so for example, January 1, 2007 data is 2006 in the chart; RRSP information from Statistics Canada: Canada's Retirement Income Programs 2006, Catalogue # 74-507XCB; Employment numbers: Statistics Canada: Labour Force Survey, Catalogue Number 71F0004XCB

Note: According to Statistics Canada information, approximately half of the RRSP contributors are also pension plan members.

Current Challenges

The gradual accumulation of rules and regulations surrounding pensions has created today's pension environment in Nova Scotia, with its attendant challenges:

Firstly, the underlying basis was built around Defined Benefit plans. But many plans today are of a different type—Defined Contribution or Target Benefit for example. The present rules often cause unnecessary complications for those plans.

Secondly, the underlying structure arose in an era when many employees worked their whole career for the same employer, in a relationship rather more paternalistic than typically exists today.

Thirdly, government has recently made a number of patchwork changes to deal with specific situations, but which have had unintended consequences for other plans.

Fourthly, recent sharp increases in liabilities for Defined Benefit plans due to improved longevity, reduced interest rates, and reduced assets due to investment performance have emphasized both the magnitude and the volatility of the cost to employers.

The result is an environment that discourages the creation and continuation of Defined Benefit pension plans. The number of members participating in employer sponsored pensions has been declining, and the proportion of employees continuing to accrue Defined Benefit pensions (felt by many to be the best arrangement for employees) is declining even faster, particularly in the private sector. Many of those sponsors who still have Defined Benefit plans are considering changes. The Panel could find no instance of a truly new private sector pension plan being implemented on a Defined Benefit basis in the last ten years.

Employee and Employer Perspectives

The Panel commissioned independent research with respect to employer and employee attitudes towards pensions[3]. Younger employees show little understanding of or interest in pension plan arrangements. This occurs in part because many do not expect to retire with their current employer. The level of interest grows with age and becomes quite strong as employees near retirement. Only at that stage do employees seriously engage with the question of retirement income adequacy. Yet most employees of all ages agree that planning for retirement is a personal responsibility.

Employers typically think of pension plans as a tool for attracting and retaining employees. They probably overestimate the value of Defined Benefit plans, at least for entry level employees. Some employers are also motivated by an altruistic desire that employees have adequate retirement income.

Union leaders have a deeper understanding than their members of the value of strong pension programs and have made them important parts of collective bargaining.

[3] Corporate Research Associates, *Pension Benefits Review Study: Final Report*, online: NS Pension Review www.gov.ns.ca/lwd/pensionreview/

Philosophical Framework: Hopes and Promises

In any pension plan, payments are made into a fund during a member's working years in order to provide a retirement income later. Sometimes it is only the employer that makes contributions to the fund, but more often employees also make payments.

A pension plan always involves a mixture of hopes and promises. The hope is that the planned contributions will be sufficient to provide the intended retirement income. Responsibility for ensuring the sufficiency of contributions differs between plan types.

In a Defined Contribution plan the plan sponsor contributes a certain amount to each member's account. That fulfills the sponsors promise. The member hopes that those contributions together with his own will be enough to support his retirement goals. In most cases his hoping is rather vague and poorly informed until he is in his forties or fifties. By that time it is very expensive to catch up if the accumulations together with future planned contributions are insufficient.

Not surprisingly many employers prefer this version, where the cost is known and predictable. Employees have tended to be willing participants in the choice of Defined Contribution plans because they can see the money and control how it is invested, and because they have not focused on how much retirement income it will buy. Recent market losses will increase interest in this question, and dissatisfaction with the answer.

In Defined Benefit programs the sponsor's contributions are only a down payment on the value of the promise that has been made. The actual cost will not be known for many years into the future, but it will certainly be both high and volatile. The sponsor makes the promise to the members and hopes that the contributions will be sufficient.

Union leaders have been more aware than their members of the advantages of Defined Benefit plans and have been highly resistant to changes that would compromise those advantages.

Very few non-union employers continue to offer Defined Benefit programs to new employees, and some have ceased accruing defined benefits for existing employees.

Plan members have been even less interested in the funding adequacy of Defined Benefit plans than they have been with Defined Contribution plans, because funding adequacy has not been their problem. Likewise union leaders have often shown too little interest in the costs to employers. Recent developments have changed that because costs have risen dramatically and in some cases have become prohibitive.

The year 2008 was extraordinarily difficult for investors. World stock markets lost half their value—about $30 *trillion*. The Canadian stock market lost 35%. Of course pension funds contain a mixture of investments, but it will be common for plans to have realized rates of return that are less than needed to support their liabilities by 20% or more.

The resulting stress on funding requirements brings into sharp focus the way that these are determined. Current legislation calls for the funding to be at the higher of the amounts determined by going concern or solvency based calculations. The former represents an excellent planning tool for plan sponsors, but it is subject to such wide discretion in practice that it has little value as a regulatory minimum.

Solvency valuations test a plan against the possibility of immediate windup. The basis for doing so is tightly defined by the actuarial profession. It is also too conservative.

So we have proposed a different basis for minimum funding of Defined Benefit plans. It is not a different going concern calculation. It is not a different solvency calculation. It is an effort to produce a mildly conservative estimate of the cost of current year promises.

It is worth emphasizing that the actual cost will not be determined by any actuary, nor by any panel, nor by any legislation or regulation. It will be determined by what happens with experience factors, principally investment returns, interest rates, and retiree longevity. Regulation does not determine the cost, only when it must be paid.

Whatever the method used to value liabilities, deficits arising from adverse experience must be addressed, in addition to current service funding. These costs will be even greater for plans that have a promise of post-retirement inflation indexing which have been excluded from their solvency valuations.

The cost will be very difficult for many plans. Some representations have argued that dealing with the problem should be postponed because a response will not be required if markets recover. Of course those who argue this really mean “when” the markets recover—which implies an assumption of truly heroic investment returns in the near future. An examination of Japanese stock market returns over the last two decades shows that this is not always the case –the Nikkei index at the end of 2008 is 40% *lower* than the level it reached after a 50% drop in the nineties. None of the representations addressed the question of what to do *if* markets continue to decline.

Others have argued that requiring deficits to be made up will result in accelerating the decline in Defined Benefit plans. We do not believe that the interests of members are well served by a regulatory environment that accepts promises that are not adequately funded. We do believe that, given the uncertainty of future investment returns, the response to deficits should be more gradual than now required.

With two very important sets of exceptions, we heard very little discussion of variability in the benefit side of the equation. The exceptions are instructive.

A Specified Multi-Employer Pension Plan (SMEPP) is typically found in the unionized part of the construction trades. Contributions for members go to the same pension plan regardless of which employer (even an out-of-province employer) they work for. Benefits are earned in proportion to contributions. The plan aims to provide a defined benefit, but this is a hope, not a promise. The employer’s responsibility is fulfilled once

the contributions are made. The plan is managed by a Board of employer and union trustees who are responsible for keeping benefits in line with funding. So when investment markets experience a difficult year either contributions need to be raised, or benefits reduced, or both. If markets recover benefits can be increased.

Jointly Sponsored Pension Plans also have joint governance through a Board of Trustees, although there is typically a guaranteed minimum benefit level, with a hope of higher benefits. For example, the difference between career average and final average benefits, or the possibility to provide post-retirement indexing, may be expressed as a hope rather than a promise. In these plans there is an understanding that funding, including future increases or decreases, are equally or proportionately shared between plan employers and members. As with SMEPPs, employee representatives on the Board of Trustees engage actively in questions of funding cost and adequacy. If the funding is targeted toward the hope as well as the promise, the additional funds represent a buffer to reduce volatility in required funding since legislatively required funding should primarily be based on the promise.

What unites these two instances is the active participation of employee representatives in the management of plan affairs, and consideration of cost/benefit tradeoffs, without abandoning the focus on ultimate retirement income. We believe this orientation will usually better serve employee interests than a change from Defined Benefit to Defined Contribution plans.

More generally, we believe that the interests of both employers and employees are served if both are involved in managing the ongoing relationship between benefits and costs, and between hopes and promises.

Multiple Employer Pension Plans are created so that employers can benefit from savings in administrative, advisory and investment costs. As well, employees can move between these employers while maintaining benefit continuity. It is normal for employee representatives to be involved in the governance of these plans.

Panel's Context

Our focus is first and foremost to create an environment where pension promises will be fulfilled. Within that context the Panel has sought to simplify government regulation and to leave to individual plans the particulars of their benefit design, subject to the required minimum standards.

> 1. Fulfilling pension promises and providing complete transparency of information are the focus of the Panel's recommendations.

This requires complete transparency of information, so that employees (and their representatives) can be fully informed on issues affecting their plan such as funding status, benefit changes, and regulatory issues. The Panel also believes that pension plans will work much better when there is active

employee involvement through joint trusteeship or other means, such as active and well- informed Advisory Committees.

Employers have a choice about whether to have a plan at all, subject of course to collective bargaining. Pension costs are money that could otherwise be used for other benefits or current wages. Different groups will want different tradeoffs. The Panel does not believe that benefit tradeoffs should be made by government.

Some of the submissions received urge a further strengthening of current requirements on pension plan sponsors---for example, requiring employee and retiree approval of any prospective changes in plans or requiring guaranteed indexing for Defined Benefit plans. The Panel believes that this approach would only serve to accelerate the decline in the number of plans. In contrast, we hope that making changes that increase the flexibility and administrative ease of Defined Benefit pension plans will be enough to at least arrest their decline.

Finally, while there are developments to be hoped for involving other jurisdictions (raising the tax limit, harmonization with other regulatory jurisdictions), we must have a legislative framework that works well with the existing environment while remaining open to potential future developments.

Goals of Pension Legislation and Regulation

While pension rules can be very complex, the goals of pension legislation should be clear. The Panel's starting point has been to create a list of overarching goals. These goals create a context for addressing complex issues:

1. To maximize the likelihood that pension promises are met by:
   (a) Isolating pension funds from employer funds;
   (b) Providing vesting protection so that benefits are not lost;
   (c) Providing appropriate rules for the protection and benefit of employees in the event of discontinuation of employment, early or late retirement; and of spouses or beneficiaries in the event of the employee's death, or marriage breakdown.
   (d) Prescribing appropriate minimum funding requirements.
2. To ensure that employees have appropriate access to information about their individual benefits;
3. To provide transparency of information about all aspects of pension plans to members; and
4. To promote and facilitate the implementation and continuation of pension plans.

> 2. The Panel provides these goals as the context for their recommendations and any resulting legislative and regulatory change.

Likewise, it is helpful to have a list of what the legislation and regulation should avoid:

1. Establishing minimal acceptable levels of benefit
2. Enforcing equity between plan members (beyond that already applicable to other forms of compensation)
3. Favoring one form of pension over others
4. Preventing new forms of pensions from being developed
5. Increasing regulatory burden either quantitatively or qualitatively
6. Discouraging the establishment or continuation of pension plans by unnecessary regulatory burden.

3. The legislation and regulation should avoid addressing this list of issues.

The bias in interpreting the Act and regulations should be permissive, not restrictive. If it is not forbidden and does not contradict the spirit of the Act and Regulations it should be permitted.

4. The bias of the PBA and its regulations should be permissive, not restrictive.

Types of Plans and Sources of Funding

There are two main types of pension plans, a Defined Contribution type and Defined Benefit. Under a Defined Contribution plan, contributions required by the employer and/or employees are clearly defined. The resulting pension benefit for each employee is whatever can be provided or purchased by the accumulated contributions and investment earnings.

A Defined Benefit plan contains a specific formula as to the amount of pension each member is to receive. Effectively, the employer promises to provide this level of benefits and it is necessary for an actuary to estimate periodically how large the fund should be and how much should be contributed to ensure adequate funding of the benefits. To date, the most common type of plan is a Defined Benefit plan.

Defined Benefit Plans versus Defined Contribution Plans

There are concerns that Canadians are not adequately saving for retirement. As noted earlier, in 2006, there were approximately 272,000 Nova Scotians who did not pay into a pension plan. While a portion of these will, presumably, have savings in the form of RRSPs or personal investments, it can be assumed that a portion will not have such savings and will rely on government retirement income such as OAS, GIS and CPP. Because many Canadians may not be adequately saving for retirement, some suggest that Defined Benefit plans should be encouraged, as they are claimed to be the best way for individuals to save for retirement. The essential feature of a Defined Benefit

plan is that sponsors promise members a pension upon retirement – sometimes a specified dollar amount; more usually an amount linked to pre-retirement earnings.[4] Defined Benefit plans don't require members to have investment expertise in order to save for retirement. In November 2005, the former Governor of the Bank of Canada, David Dodge, encouraged employers to maintain Defined Benefit plans and confirmed their importance as an "economically efficient way of transferring risk to those that are best able to bear it".[5]

In contrast to Mr. Dodge's view, however, is the fact that Defined Benefit pension plans are not as popular with employers as they once were due to the risks associated with them. Some employers are closing out their Defined Benefit plans to new members and are moving to Defined Contribution plans or other savings plans, such as Group Registered Retirement Savings Plans. The obligations of most Defined Benefit plans are liabilities to sponsors.[6] Employers in single-employer plans bear the risk of investing properly, considering declining long-term interest rates, rapidly improving longevity, and being responsible for any deficits that may result. While surpluses are also possible, employers may not be entitled to them. The issue of surplus is contentious and will be discussed in more detail later. As a result of this "asymmetry", employers bear all of the responsibility and may not see any or much of the benefits from good investments on their part. According to Towers Perrin, "Private sector coverage by Canadian pension plans, particularly Defined Benefit plans, has eroded over the past 15 years and virtually no new Defined Benefit plans are now being established"[7]. Ultimately, sponsors are not happy about the cost of Defined Benefit plans, the exposure to risk from these plans, and the fact that many employees do not appreciate Defined Benefit plans until they are close to retirement.

There were a total of 177 active Defined Benefit plans regulated by Nova Scotia as of April 2008. The following is a breakdown of how many plans were admitting new members versus those that were not:

	Public Plans	Private Plans
Plans admitting new DB members	19	145
Plans not admitting new DB members	1	12

[4] David Laidler and William BP Robson, *Ill-Defined Benefits: The Uncertain Present and Brighter Future of Employee pensions in Canada* (June 2007) CD Howe Institute Commentary, No 250 at 2.
[5] Towers Perrin, *The 21st Century Pension System: Solving the DB Funding Conundrum* (January 2008) at 3, online: Towers Perrin www.towersperrin.com/tp/getwebcachedoc?country=cane&webc=HRS/CAN/2008/200801/DB_Funding_Conundrum.pdf
[6] David Laidler and William BP Robson, *Ill-Defined Benefits: The Uncertain Present and Brighter Future of Employee pensions in Canada* (June 2007) CD Howe Institute Commentary, No 250 at 3.
[7] Towers Perrin, *The 21st Century Pension System: Solving the DB Funding Conundrum* (January 2008) at 3, online: Towers Perrin www.towersperrin.com/tp/getwebcachedoc?country=cane&webc=HRS/CAN/2008/200801/DB_Funding_Conundrum.pdf

Approximately 8% of active Defined Benefit plans regulated by Nova Scotia are not admitting new members to the plan.

In the case of Defined Contribution plans, surplus and underfunding issues don't apply, and there is no volatility for employers because costs are a fixed percentage of payroll. In most plans, plan members direct their investments. The biggest risk for plan members is retiring with insufficient funds[8] due to such things as contributions that are too low, poor investments, high fees, and untimely cash-outs. However, the sponsor is involved in the selection of investment managers and the investment vehicles that are offered. As a result, the sponsor bears the risk of criticism and possible litigation due to failure to educate members, poor selection of investment vehicles and managers[9], and excessive fees on investments.

While members bear the investment risk, one of the benefits to Defined Contribution plans is the portability. Defined Contribution benefits are linked to individuals, rather than a pool of contributors. As some workers change jobs fairly often, an individual's ability to take their pension benefits with them may be very attractive.

Some concerns about Defined Contribution plans include the restrictions on auto-enrolment and default contribution rates, and the necessity to convert funds on a particular day. The requirement to convert retirement funds as of the date of retirement, regardless of the interest rate levels etc on that day, is not always the best option for members. The possibility of a member being able to leave their assets in the plan and receive a Life Income Fund(LIF) type payment, while letting the employer continue to manage the investments, might be advantageous to a member. That type of arrangement is not currently available under the legislation, although it is contemplated under CAPSA model law.

Specified Multi-Employer Pension Plans

Specified Multi-Employer Pension Plans are typically for unionized workers in the building trades who are hired for construction projects. Pension contributions are made for each hour worked by the employee. The plans are administered by a Joint Board of Trustees. The solvency funding rules apply to SMEPPs, however, there is a difference in how funding deficits are handled. While normally a Defined Benefit plan sponsor must fund any deficits, in the case of SMEPPs, the plan employers only contribute what has been negotiated in the collective agreement. The Trustees must adjust the accrued benefits to the level that is funded until such time that the union and employers may

[8] Towers Perrin, *Emerging Trends and Directions in Pension Governance* (2007) at 3, online: Towers Perrin www.towersperrin.com/tp/getwebcachedoc?country=cane&webc=HRS/CAN/2007/200711/Towers_Perrin_Pension_Governance_E.pdf

[9] Gordon Hall, *20 Questions Directors Should Ask About their Role in Pension Governance* (2003) at 8 online: Canadian Institute of Chartered Accountants www.cica.ca/multimedia/Download_Library/Research_Guidance/Risk_Management_Governance/Recent_Publications/CICA_20Qs_PensionsENG.pdf

renegotiate the level of contributions to the plan.[10] SMEPPs are different from Defined Benefit plans because they are permitted and, in some instances required, to reduce benefits, rather than be required to increase the contributions. In other words, SMEPPs are committed to working towards a Target Benefit (see below).

As noted earlier, the Province of Nova Scotia has amended the *Pension Benefits Act* Regulations to provide for a three-year exemption from solvency funding for specified multi-employer pension plans. Because of these changes, specified multi-employer pension plans will not have to make an immediate reduction in accrued benefits to meet the solvency funding requirements. The temporary relief addressed immediate funding concerns for specified multi-employer plans. However, future funding rules must now be addressed.

Jointly Sponsored Pension Plans

Jointly Sponsored Pension Plans (JSPPs) are different from single employer Defined Benefit plans:

(a) Active members in Jointly Sponsored plans participate with the employer(s) in establishing contribution levels that will keep the plan properly funded.

(b) Contributions are also shared with the employer(s) paying at least 50% of the total contributions. The joint governance structure of JSPPs allows future contributions and benefit accruals to be rebalanced as required by the level of funding of the plan.

> 5. Jointly Sponsored Plans, as described, should be recognized in the PBA and its regulations.

(c) In these plans surpluses will only be used for either contribution holidays or for improving benefits.

The current Act does not contemplate JSPPs, however, the Panel recommends that Nova Scotia's legislation recognize these types of plans. We also recommend that in order for a plan to be considered a JSPP, it must apply to the Superintendent requesting recognition as a JSPP. This type of plan may apply to a single employer or multiple employers.

Target Benefit Plans

While Defined Benefit and Defined Contribution pension plans are common pension plan designs, Target Benefit plans may not be familiar to some. There are a number of

[10] Bruce Cohen and Brian Fitzgerald, *The Pension Puzzle: Your Complete Guide to Government Benefits*, *RRSPs and Employer Plans*, 3d ed. (Mississauga: John Wiley & Sons Canada, Ltd., 2007) at 65-66.

forms of Target Benefit plans in Nova Scotia and other jurisdictions. The format generally includes Defined Contribution funding with a particular level of benefit being targeted. Both contributions and benefit levels are potentially changeable as circumstances warrant. A very attractive feature of these plans is the joint trusteeship model between employees and their employer(s). SMEPPs are Target Benefit Plans, but the Target Benefit model could and should be utilized more broadly.

Target Benefit Plans should:

(a) Be available for single or multiple-employer groups. (Specified Multi-Employer Pension Plans are an example of this format.);

(b) Be jointly governed;

(c) Require the employer(s) to pay at least 50% of the total contributions.

(d) Be required to use all contributions for provision of benefits and plan expenses.

6. Target Benefit plans, as described, should be more broadly available.

It is important to emphasize that the legislation should be flexible enough to accommodate, not only known plan designs and funding sources, but also to accommodate any new plan designs and funding sources that may be created in the future.

The legislation should be flexible enough to enable the following types of benefit design and funding sources:

Benefit Design:

- Defined Benefit plans
- Defined Contribution plans
- Target Benefit plans
- Combinations of the above benefit designs
- Accommodation of new designs by subsequent regulation

7. The Legislation and Regulations should permit new plan designs.

Funding Sources:

- Employees
- Single employer
- Multi-employer
- Accommodation of other arrangements by subsequent regulation

Funding of Defined Benefit Plans

There are currently two legislated funding requirements: going concern funding and solvency funding. Going concern funding looks at the plan's funded status on the basis that the plan will continue to operate indefinitely.[11] Solvency funding tests whether a plan has sufficient assets to cover all the liabilities of the plan in the event of a wind up.

Solvency valuations are the measure used to determine the degree of security of Defined Benefit plans. Some of the factors included in these valuations are retirement age assumptions, and future longevity and investment returns. A plan is not considered fully solvent unless it has enough assets to meet all of its obligations in the event of a wind-up.

Of the Defined Benefit plans registered in Nova Scotia in 2001, 93% of members were in plans that were fully funded on a solvency basis. That number had reduced to 82% in 2002, to 69% in 2003 and to 49% in 2004. In 2005, the proportion of members in plans that were fully funded on a solvency basis had risen to 56%; however, in 2006, this number fell again to 53%.

In Nova Scotia, if Defined Benefit plans are not fully solvent, they must have funding in place to achieve full solvency funding within five years. However, there are currently three temporary exceptions to the requirement to achieve full solvency funding within five years.

Firstly, the Province of Nova Scotia temporarily provided university plans additional flexibility in funding their plans and amended the Regulations in 2005 to allow universities a time extension to pay back any solvency deficiencies over 15 years as opposed to five. This extension applies only to solvency deficiencies that arose prior to January 1, 2006 under university pension plans. If there is a partial wind up of a university plan, due to outsourcing a particular service or terminating a program, immediate and full funding of the benefits payable in respect of those employees is required. The original solvency funding rules would apply to any subsequent deficits and the deficit would have to be funded within five years.

Secondly, the Province of Nova Scotia has amended the *Pension Benefits Act* Regulations to provide for a three-year exemption from solvency funding for specified multi-employer pension plans for plans that perform valuations prior to November 1, 2010. Because of these changes, specified multi-employer pension plans will not have to make an immediate reduction in accrued benefits to meet the solvency funding requirements. The temporary relief addressed immediate funding concerns for specified multi-employer plans.

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[11] Cameron Hunter, Tom Levy, Michael Mazzuca and H. Clare Pitcher, *Saved from Solvency Funding* (November 2007) Benefits Canada at 57, online: Benefits Canada www.benefitscanada.com/pension/db/article.jsp?content=20071129_141520_6144

Finally, the Province of Nova Scotia has responded to some concerns around solvency funding requirements for municipalities. In 2006 and 2007, the Province amended the *Pension Benefits Act* Regulations to provide an exemption for municipalities to the requirement to fully fund a new solvency deficiency over five years. For the period of time between August 30, 2006 and August 30, 2016, municipalities can elect to fund their plans to only 85% solvency, with solvency payments to be made over a five-year period. Any deficiency on partial wind-up must be fully funded. During the period of solvency funding relief, no amendments can be made to increase the liabilities of a municipality pension plan unless the cost of the amendment is paid at the time the amendment is made. This exemption is only available for the next ten years. As a result, under this exemption, if a municipal plan is not 100% solvency funded, it cannot offer its members an increase to pensions in pay as a means of mitigating inflation. Some see this as unfair. Without indexation, pensioners lose their dollar value quickly, even during times of low inflation.

The solvency funding rules for universities, municipalities and multi-employer pension plans vary across the country. See Appendix D for examples.

Many municipal, university and other quasi-governmental groups have argued that the solvency test on Defined Benefit funding does not make sense for them because they will be around indefinitely and have direct or indirect taxing power. We have heard arguments that going concern measures should therefore be used, or that no deficit amortizations are needed.

To the extent that these plans are in a deficit position, these exemptions create a de facto transfer of cost to future generations of taxpayers and students. Further we do not agree with the implied notion that all municipalities and universities are more credit-worthy than all private organizations—it is not difficult to cite counter-examples. And we do not believe that the Superintendent of Pensions should be in the business of evaluating creditworthiness.

Municipalities in the Province of Nova Scotia are required to pay for current operating expenses with current taxes. The value of a current year obligation for pension funding (including benefit accrual and deficit amortization) is a current year operating expense. Universities, with less direct access to the taxpayer, can hardly argue for more favourable treatment.

Going concern valuations are a vitally important part of actuarial practice for pension plans. They enable plan sponsors or trustees to visualize a long-term funding policy for the plan. But there is a great deal of discretion available in the choice of assumptions. As such they are of no practical value as regulatory standards.

Solvency valuations test a plan against the possibility of immediate wind-up. The basis of doing so is tightly defined by the actuarial profession. It is also rather conservative. Not surprisingly we received many submissions arguing that the conservatism is excessive. We agree, although not with the suggestion that this somehow makes a

going concern valuation a sufficient test. But we also dislike solvency valuations because they ignore promises about post-retirement indexing. Liability calculations are the same for two otherwise identical plans; one of which makes this valuable (and expensive) promise and one which does not. This is nonsense.

We favour a legislative minimum which produces a mildly conservative estimate of the cost of promises. We propose that valuations be made on an Accrued Benefit basis (see Appendix B) which includes consideration of ALL promises, but which is done using actuarial assumptions closer to those for going concern valuations.

Both surpluses and deficits should be amortized over ten years, with interest.
In summary, the Panel developed the following baseline for minimum funding:

(a) Tests of funding adequacy must value **all promises** made.

(b) On wind-up, plans have to fully fund the benefits promised. The minimum basis for doing so is the proposed valuation standard.

(c) The rules for minimum funding should be the same for all pension plans subject to the *Pension Benefits Act*.

8. The Panel recommends these rules in relation to minimum funding for Defined Benefit plans.

(d) No benefit improvements should be allowed if the plan is in deficit, unless they:
(1) first pay off the deficit in full; or
(2) pre-pay for the benefit improvement in full; or
(3) they may pay for the improvement in annual installments, so long as the improvement is considered a hope, rather than a promise, until it is fully funded. In other words, the members must be clearly advised that the benefit improvement will not become a promised benefit until it is fully funded.
(4) Different rules apply for Target Benefit Plans, including SMEPPs, as described in the next section Determining and Responding to Deficits.

(e) All valuations must be filed within six months of the effective date of the valuation, with provisions for fines if the timeline is not met.

This would be the only regulatory requirement for minimum funding. But plans will frequently want to perform other tests, such as going concern valuations, in support of their funding policy.

Also, a plan may decide to fund on a more conservative basis than the minimum, in that the hopes for benefit improvement may be realized. An example might be a Defined Benefit plan where the annual pension accruals are based on current salary, but periodically surpluses emerging are used to update credits from earlier years.

Some submissions were critical of the fact that the proposed rules for minimum funding were not applied to the provincial pension plans. However, the mandate of the Pension Review Panel was to review and make recommendations with respect to pension plans that were subject to the *Pension Benefits Act* only. The public pension plans are subject to separate legislation.

Determining and Responding to Deficits

Currently, the amortization period to achieve full funding of solvency deficits is five years. However, three exceptions to this five year rule currently apply. Universities have been given a temporary extension of their amortization period to 15 years for pre-2006 deficits. Specified Multi-employer pension plans have been provided with a three year exemption from solvency funding, and finally, municipalities were provided a temporary exemption until 2016 from the requirement to fully fund a deficit over five years. Rather, they are required to fund only to 85% solvency over the five year period.

The rules ensuring minimum funding should apply equally to all plans. The Panel recommends that all plans subject to the PBA should have an amortization period for deficits over a maximum of ten years, which, once the legislative changes are made, would apply to sponsors from the next valuation date onwards.

> 9. The Panel recommends the institution of these rules, and the mechanism described in Appendix B, when determining and responding to deficits.

As noted in the Discussion Paper and most of the submissions provided to the Panel, given the many factors that can impact a plan's solvency level, there is financial risk associated with Defined Benefit pension plans. For example, a decline in the financial markets can change a plan's solvency position from surplus to deficit, or vice versa, in a very short time frame. The Panel proposes ways in which this volatility should be mitigated:

(a) A "collar" of 5% should be provided. That is, at the time of valuation, if a plan is funded at 95% or less, then the plan **may** make payments towards the deficit, but is not required to do so. Any deficits over the 5% collar **must** be amortized.

(b) Actuarial valuations must occur at least once every three years.

(c) Plans must perform a test each year as of the anniversary of the most recent full valuation. The purpose of these tests would be to provide information on the health of the plan. These tests would update the most recent valuation by calculating:

   (1) The impact of the difference between actual and expected return on mean assets; and

   (2) The impact of the change in yield on liabilities at the last valuation.

If the test shows that the plan may be in deficit by more than 5%, a full valuation must be performed and must be filed with the Superintendent within six months of the effective date of the valuation, with provisions for fines if this timeline is not met.

(d) If a plan begins to amortize a deficit over ten years and the next year reveals a lower deficit than expected, then the reduced overall deficit may be amortized over the remaining nine years.

A valuation that shows a reduction in the deficit of the plan will not be accepted unless it is filed within six months of the effective date of the valuation.

(e) If a subsequent valuation, including a valuation required under (c) shows an increase in deficit, then the previous deficit amortization schedule continues and a new amortization schedule for the new deficit will begin. For example, if a plan is 93% funded in 2010, it will be given up to ten years (to 2020) to amortize that deficit. If a new valuation in 2011 shows that the plan is now only 88% funded, while the original deficit will still have nine years left (until 2020) to amortize, the incremental deficit will have a maximum of ten years.

(f) For Target Benefits plans, including SMEPPs, paragraphs (a), (b) and (c) apply. For plans where both benefits and contributions are fully adjustable, the plan must, after any valuation showing a funding level of less than 95%, adjust benefits to a level not greater than one that can, using the same methodology in Appendix B, be fully supported by the existing assets plus all future contributions in respect of existing plan members. Benefit improvements can only be made when there is a safety margin of at least 10%. That is, the benefits can be supported by 90% of current assets and future contributions.

(g) For plans that have both a promised defined benefit and a higher target benefit that has been communicated to members, the funding rules for defined benefit plan apply to the promised benefit. In addition, the target benefit that is communicated to members can not be greater than the level that can be supported as described in (f).

(h) If a deficit requires an increase in contributions, jointly from the sponsor(s) and the members, the increases in contribution rates are not required to be retroactive to the original valuation date. The plans will be allowed up to a year from the valuation date to begin making the increased contributions. However, the end date will be the same, ten years from the valuation date. In other words, if the amortization begins one year after the valuation date, the annual payment will be enough to amortize the total deficit over nine years.

(i) Smoothing of assets is not permitted.

Surplus Considerations and Recommendations

Surpluses are only an issue for Defined Benefit plans. When the assets of a plan exceed the liabilities, the excess is considered a surplus. However, it is important to note that a surplus does not mean that there will always be extra money in the pension fund.[12] Surpluses, like deficits, are tied to the pension plan's investments, so while a rise in the market today could mean a surplus, a dip in the market tomorrow could leave a plan in deficit. Defined Benefit plans can do better than expected and find themselves in a surplus situation. Therefore, it could be argued that a surplus isn't a surplus until wind-up. It is just a temporary estimate of over-funding and could easily change as a result of variations in markets or interest rates.

The question of surplus ownership is contentious. It has been before the court on more than one occasion, but questions remain. In the 2004 Monsanto case, the Supreme Court of Canada stated that "a surplus is, in effect, a windfall because it was not within the expectations of either the employer or the employees when the regime was implemented". As a result, the court decided that on a partial wind-up, surpluses should be distributed immediately.[13]

Case law, however, is not the only factor when it comes to surpluses. Legislative provisions also play a part. The *Income Tax Act* only allows pension plans to be funded to a maximum of 110%. As a result, sponsors cannot contribute beyond this amount, which often leads to contribution holidays for sponsors. Many suggest that this 10% limit should be increased. [14] As a result of case law and legislative issues, sponsors are disinterested in accumulating a surplus to which they may not be entitled. Our concern is that by contributing the minimum amount, plans will find they are in deficit if their investments drop in value.

Some recent jurisprudence declares that pensions are considered as "deferred wages". The concept of employees and employers making contributions today for a future pension is seen by some employees and employers as putting current wages in a pension plan rather than placing that same money in the weekly pay package of the employee.

The concept of "deferred wages" conflicts with other views that the full burden of pension funding rests with employers.

Thus, there is often a conflict position over the basic and underlying concepts of funding pension plans. This conflict pits expectations of past and current members against aspirations of potential future members.

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[12] Bruce Cohen and Brian Fitzgerald, *The Pension Puzzle: Your Complete Guide to Government Benefits*, *RRSPs and Employer Plans*, 3d ed. (Mississauga: John Wiley & Sons Canada, Ltd., 2007) at 147.
[13] *Monsanto Canada Inc.* v. *Ontario (Superintendent of Financial Services*) 2004 S.C.C. 54
[14] David Laidler and William BP Robson, *Ill-Defined Benefits: The Uncertain Present and Brighter Future of Employee pensions in Canada* (June 2007) CD Howe Institute Commentary, No 250 at 9.

It was noted in the Discussion Paper and in many of the submissions that an "asymmetry" exists between employers/sponsors and employees in Defined Benefit pension plans. While the Panel agrees that an "asymmetry" exists, it does not agree that this means that employers/sponsors carry all the risks, while employees carry none. Employees are at risk that the employer may cease to exist or be sold to a new owner who chooses to terminate the plan. Employees are also at risk of being asked to make additional contributions if the plan requires increased funding.

In the case of surplus, many of the submissions indicated that plans are often minimally funded due to the uncertainty of surplus use and ownership. The Panel has recognized this and considered how the impact of volatility of the funding position could be mitigated:

> 10. The Panel makes these recommendations with respect to the use and distribution of plan surplus.

(a) As with deficits, surplus should be amortized over a minimum of ten years, with interest. This would allow plans to benefit from the surplus slowly, which would provide a cushion to mitigate future changes in funding status. Amortization would be through prospective reductions in minimum funding requirements.

(b) As with deficits, there should be a 5% collar for surplus. Any surplus up to 5% of minimum funding **cannot** be amortized. Any surplus above the 5% could be amortized. For example, if a plan had funding of 110% of minimum, the plan would have the option of amortizing the surplus towards 100%. However, if at the next valuation, the surplus is between 100% and 105%, the amortization must stop.

(c) With respect to active plans, the plan administrator can determine who is entitled to the benefits of any surplus, subject to plan rules, and the impact of collective bargaining. But the result of any choice must be that the sponsoring employer(s) has paid at least 50% of the net contributions over the previous ten years.

(d) Cash may be withdrawn only after plan wind up when all obligations have been fully met, or in rare cases where the surplus is greater than the present value of ten years worth of contributions (see (f) below). The determination of the division of surplus on wind-up will depend on the share of contributions over the previous ten years. For example, if the sponsor(s) contributed 70% while the members contributed 30%, the surplus would be divided 70-30 as well. However, the division of surplus is always subject to the requirement that the sponsoring employer(s) has paid at least 50% of the net contributions over the previous ten years.

(e) In the case of Defined Benefit plans, those plans that are above the 105% collar may use the surplus to improve benefits. However, the improvement of benefits should not bring the plan below 100%.

(f) Any time the surplus reaches a level greater than the present value of ten years worth of contributions, the surplus above that level must be removed by a cash distribution or improvement of benefits. However, any transaction is subject to the requirement that the sponsoring employer(s) has paid at least 50% of the net contributions over the previous ten years.

Ancillary Benefits

Section 48(1) of the Act states that a pension plan may provide ancillary benefits. Benefits such as disability benefits, bridging benefits, supplemental benefits, and early retirement options and benefits have been considered as ancillary. Currently, the legislation allows a plan sponsor to make amendments to a plan that will result in the removal of all or a portion of the ancillary benefits for those members who have not yet met the eligibility requirements for entitlement to the ancillary benefit(s).

This means that while many active plan members may believe that some of their benefits, such as subsidized early retirement benefits, are guaranteed, in fact, these benefits may be removed from the plan if a sponsor feels that it is financially prudent.

The Panel believes that some of these benefits should be treated like all other benefits, and if they are promised, they should be paid for and sponsors should not be able to have them removed retroactively. Accordingly, the Panel recommends the following:

> 11. Ancillary Benefit promises should be treated like all other promises.

(a) In the case of disability benefits and benefits payable as a result of the member's death before retirement in excess of the required amount (according to the current section 56 of the Act), subject to collective bargaining if applicable, sponsors may reduce or remove them, but only after five years notice to members.

(b) Subsection (f) under section 48(1) describes "postponed retirement options and benefits in excess of those referred to in subsection (4) of Section 41" as ancillary benefits. Given that the Panel is recommending that Phased Retirement be permitted, this benefit should be removed from the Ancillary Benefit section of the Act and should be dealt with under Phased Retirement provisions.

(c) With respect to all other benefits mentioned under section 48(1), if they are promised benefits under the plan, then these benefits can only be removed or reduced for future accruals, subject to collective bargaining where applicable.

Funding Transition Rules

Municipalities and organizations providing inflation indexing will experience abrupt increases in liabilities because of the new rules. To ease the transition, the Panel has laid out transition rules for the new funding model in Appendix C.

> 12. The recommended Funding Transition Rules are outlined in Appendix C.

Partial Wind-ups

A "partial wind-up" means the termination of part of a pension plan while the remainder of the plan continues to exist. This can happen in many situations, such as one plant owned by an employer closes, or when a significant number of members of the plan are terminated. Partial wind-ups currently require the distribution of the assets of the pension fund related to that part of the pension plan that has been wound up, including any possible surplus in the plan.

The current section on partial wind-ups should be eliminated from the legislation.

> 13. Partial Wind-ups should be eliminated from the legislation and these rules instituted.

The legislation should indicate that upon termination, whether one individual or a group, the member(s) should be able to take the commuted value with him/her, calculated on the same basis as the minimum funding standard. If the withdrawal occurs while the plan is in deficit, the sponsor will be responsible for making up the deficit that was associated with the departing employee(s). This payment must be made within one year of departure, but payment is not required if the total arising in a year is less than 1% of liabilities.

No surplus distribution is required on termination of individuals or groups.

Successor Plans

Under the current rules, when an employer establishes a new plan as a successor to an existing plan, and ceases to make contributions to the original plan, the original plan is not wound up. The new plan is deemed to be a continuation of the original plan. The benefits under the original plan are deemed to be benefits under the new pension plan, and this is the case regardless of whether or not the assets and liabilities of the original plan are consolidated with the new plan.

Transfers of assets from the original plan to the new plan are not permitted without the consent of the Superintendent. The Superintendent can only refuse a transfer if the benefits are not protected, or if the prescribed requirements and qualifications are not

met. However, currently, there are no Regulations that prescribe any requirements and qualifications.

The Panel recommends that if an original plan is closed to new members and there are no new accruals, any surplus in an original plan should be transferable to the new plan according to the surplus rules that are noted earlier in this report.

14. Surplus should be transferable to Successor Plans.

Investments

The *Pension Benefits Act* itself makes reference to investments in Section 29 which is entitled, "Care, Diligence, Knowledge and Skill." The section covers all aspects of the administration of a pension plan, with the reference to investment in 29(1) and 29(2).

> 29(1) the administrator of a pension plan shall exercise the care, diligence and skill in the administration and investment of the pension fund that a person or ordinary prudence would exercise in dealing with the property of another person.
>
> 29(2) The administrator or, if the administrator is a committee or a board of trustees, a member of the committee or board shall use in the administration of the pension plan, and in the administration and investment of the pension fund, all relevant knowledge and skill that the administrator or member possess or, by reason of profession, business or calling, ought to possess.

Schedule I in the Regulations contains instructions on the management of the investments and the requirement that every plan create a detailed investment policy. Then in Schedule III there is an extensive and detailed list of permitted investments which may be held in the fund.

It is significant that the foundation for investment of pension plans is built on references to prudence and application of professional or special knowledge. This foundation takes on greater importance when volatility of investment markets and the consequent impact of the funding status of the plan is considered. In addition, there has been a sharp increase in the number and complexity of new investment instruments being used. The current criticism of losses to investors has been linked, in part, to the failure of investors to understand the nature of new investment instruments.

For pension regulation this evolving situation calls for more intense attention to the governance of the investment process in plans, and less attention on prescriptive lists of acceptable investments or quantitative limits on certain classes of investment.

For these reasons the Panel recommends a strengthening of the governance process and the removal of specific investment limits. Schedule I to the Regulations should be continued and expanded as necessary, while Schedule III should be removed.

The expansion of Schedule I should include a separate section on the investment of Defined Contribution plans and other plans where the member is involved in the decision process which will affect the investment results for his/her own pension and thereby the adequacy of pension income.

15. Investment regulations should continue to emphasize prudent management, with a new section on Defined Contribution plans. A Specific list of permitted investments should be eliminated.

The Panel believes that improving the regulations in this manner, combined with the renewed emphasis on accessibility to members of all plan governance documents, will create a better future environment for the understanding of risks in Defined Benefit plans and the partnership between administrator and members in Defined Contribution plans.

In 2004, the Joint Forum of Financial Market Regulators released the Guidelines for Capital Accumulation Plans (CAP). CAPs are investment or savings plans that permit members of a CAP to make investment decisions among two or more options offered within a plan. Defined Contribution plans are one example of a CAP. The intent of the Guidelines is to:

- outline and clarify the rights and responsibilities of CAP sponsors, service providers and CAP members; and
- to ensure that CAP members are provided information and assistance that they need to make investment decisions.

The CAP Guidelines are voluntary; however, the Canadian Association of Pension Supervisory Authorities (CAPSA) expected that all CAPs operate in accordance with these guidelines by December 31, 2005.[15]

The Panel recommends that sponsors should determine the investment choices to be offered to employees, keeping in mind the following requirements:

a) The options offered to employees by the sponsor should be chosen prudently;
b) There should be good communication to the members about the investment choices available;
c) The member should be provided with information and projection tools in order to calculate the possible results and risks from various choices and the effect on his/her ultimate pension.

[15] CAPSA, *Guideline No. 3: Guidelines for Capital Accumulation Plans* (May 2004), online: CAPSA www.capsa-acor.org/capsa-newhome.nsf/4a5938dfa169be3285256c1a00752c5d/bbe9515c561d349485256e91004f5e64?OpenDocument

Legislation should permit a plan to require default enrolment of members when they become eligible to join the plan and default investment mix selection for members of Defined Contribution plans who fail to make their own selection.

"Safe Harbour" Rules

Sponsors want to limit their liability for financial risks in pension plans. This has led many to offer Defined Contribution pension plans rather than Defined Benefit pension plans. However, employers are still concerned about the investments that are needed with Defined Contribution plans. As discussed earlier, while employees bear the investment risk, sponsors, as managers, are still at risk if they choose poor investment options.

It has therefore been suggested that the legislation be amended so that employers are protected from litigation if they follow certain "best practices". The U.S. has such "safe harbour" rules.

> 16. "Safe Harbour" rules should not be included in the regulations.

To put "safe harbour" rules in place would be impractical and harmfully prescriptive.

Prudent attention and action under the established investment policies for the plan should be sufficient mitigation of liability.

Further we wish to reemphasize that Defined Contribution plans should be treated as a partnership and specifically that Defined Contribution plans should be required to provide to members each year a statement of what pension they can expect to receive under several investment return and interest rate scenarios. This will provide members early warning about potentially inadequate benefits and will often encourage higher savings rates.

Governance

Good pension governance is important not only to pension plans and their individual members, but also to society at large and to the economy. Litigation in the area of pensions is on the rise, especially in the areas of fund surpluses, benefit administration and payment of expenses.[16]

The main objective of the *Pension Benefits Act* is to safeguard employee entitlements to benefits promised under pension plans. It is known in the pension industry that

[16] David Laidler and William BP Robson, *Ill-Defined Benefits: The Uncertain Present and Brighter Future of Employee pensions in Canada* (June 2007) CD Howe Institute Commentary, No 250 at 4-5.

inadequate governance of pension plans can cause many problems for a plan, including underfunding. However, adequate governance requires not only a plan, but also full transparency with plan members. The risks and uncertainties, as well as who is responsible for them must be clearly communicated.

Given the concerns around inadequate governance, CAPSA has developed "Pension Plan Governance Guidelines" which were designed to assist pension plan administrators to fulfill their governance responsibilities by "achieving and maintaining good governance practices". These guidelines do not provide "safe harbour" protection.[17] To date, no Canadian jurisdiction has defined or legislated what is "good governance". To do so would be extremely difficult. Putting rules around governance would place greater responsibility on the Superintendent of Pensions and would require more resources to supervise. Quebec has instituted some new governance rules, such as requiring pension committees to adopt internal by-laws to establish their rules of operation and governance. The Quebec Supplemental Pension Plans Act lists ten matters that must be covered by internal bylaws. These include things such as: ethics rules, duties and obligations of members, procedures for and frequency of meetings, risk management measures, internal controls, and standards that apply to the services rendered by the Committee.[18]

Good governance of pension plans is a matter of prudence today. Well managed pension plans have a variety of governance models. The Panel recognizes this development in the management of pension plans and, therefore, makes the following recommendations:

(a) All pension plans must file with the Superintendent of Pensions a copy of their Governance Plan which have been adopted by the Administrator and circulated to the Advisory Committee, Union, or employees, as appropriate.

17. Governance should follow best practices. Self-Assessment and Transparency are important parts of the regulatory framework.

(b) The governance policy shall speak to issues including:

(i) governance objectives – the administrator should establish objectives for the oversight, management and administration of the plan.

(ii) roles and responsibilities – clearly describe and document the roles, responsibilities, and accountability of all participants

(iii) performance measures – establish performance measures and monitor the performance of participants who have decision making authority

[17] Ian McSweeney, Michael Benoit and Sandra W. Cohen, *Canadian Pension Law* (2007) 2006/2007Lexpert CCCA/ACCJE Corporate Counsel Directory and Yearbook, online: www.osler.com/uploadedFiles/Resources/Publications/OslerHoskinHarcourtLLP-Lexpert-Pensions&Benefits.pdf

[18] Regie Des Rentes Du Quebec, *Newsletter: Supplemental Pension Plans*(Dec 2007) Regie Des Rentes Du Quebec, Number 22.

(iv) knowledge and skills – administrator has a duty to apply knowledge and skills needed to meet his/her responsibilities

(v) access to information – the administrator, sponsor, and plan members should have access to relevant, timely and accurate information.

(vi) risk management – establish an internal control framework which addresses the plan's risks.

(vii) oversight and compliance – establish appropriate mechanisms to oversee and ensure compliance with the legislative requirements and pension plan documents and administrative policies

(viii) transparency and accountability – provide for the communication of the governance process to plan members, including how and how often information on benefits will be provided. All information should be provided to members, except for information that will offend FOIPOP by identifying data particular to an individual.

(ix) code of conduct and conflict of interest – establish a code of conduct and a policy to address conflicts of interest

(x) governance review – administrator should conduct a regular review of plan governance

(xi) fiduciary responsibility – administrator has fiduciary and other duties to plan members, and possibly, to other stakeholders.

In the context of governance, members include active members, former members with deferred benefits and retired members or their beneficiaries with benefits still in pay.

(c) The Administrator shall provide a self-evaluation of the governance plan with respect to the criteria listed in (b) and shall certify in its annual filing that the Governance Plan that has been filed is being complied with, and if it has been altered, what are those alterations.

(d) Given the limited resources of the Office of the Superintendent, we do not believe that the Superintendent should be required to review each governance policy in detail.

The Superintendent shall review the self-assessments to ensure that suitable content and compliance is being certified. Concerns by either plan members, or the Superintendent, about the governance plan or compliance to it, could be

reviewed by the Superintendent. In the absence of such concerns, the Superintendent would simply file the documents.

(e) Failure to follow filed Governance plans shall be deemed to be evidence of lack of prudence by the Administrator under the provisions of the *Act*.

Employee and/or union involvement in plan administration and governance should be encouraged and any regulatory inhibitions removed.

Advisory Committees

The current legislation allows employees in plans of over 50 members to set up an Advisory Committee, whether an employer supports it or not. However, most plans do not have them. One reason could be that Advisory Committees have little power to influence sponsors. Advisory Committees are and should remain voluntary, but they should be given greater ability to influence sponsors and regulators.

Specifically, Advisory Committees should be given, simultaneously, any documents that the sponsor files with the Superintendent, subject only to privacy protection for information pertaining to individuals. Advisory Committees should also be entitled to have reasonable access to plan actuaries, investment managers and other professionals, for explanations of plan documents filed with the Superintendent. The Panel envisions that Advisory Committees may seek out explanations from the plan actuaries in response to a report, amendment, etc. The plan would be responsible for funding the costs associated with consulting professionals. If an employer/sponsor would like to have work done that they wish to remain private, that work should be paid for by the employer/sponsor, rather than the plan. Any work paid for by the plan should be accessible by both the employer/sponsor and the Advisory Committee.

The representatives on Advisory Committees should be representative of the members of the plan. The Committees must include active members and at least one retired member. The Committee may include non-active members with deferred benefits. The number of Committee members should equal 1% of active members in the plan, subject to a minimum of three people and a maximum of ten.

18. The creation and use of Advisory Committees should be encouraged. Advisory Committees should have access to information and plan Advisors.

The selection of the Committee shall depend on whether the plan is in a union or non-union environment. In non-union environments, plan sponsor(s) will choose the members of the Committee that are reasonably representative of the active members, preferably in consultation with the active members. In a union environment, the union will appoint representatives for the union part of the plan, for both active members and union retirees. If the plan has a combination of union and non-union members, the

union shall appoint its members in proportion to the number of union members in the plan, with the sponsor(s) selecting the remainder.

Advisory Committees need orientation and training. The sponsor has an obligation to ensure Advisory Committees receive reasonable orientation and training. Training and providing support to Advisory Committees should be part of the mandate of a promotion division within the Department of Labour and Workforce Development.

Access to Information

Plan sponsors are already required to furnish employees with information about their own benefits, but the requirements to share information about overall plan operations and funding status are limited. For most members the plan is their primary financial asset and we believe they have the right to be well informed.

Every formal report or plan document that a sponsor/administrator files with the Superintendent of Pensions should be provided simultaneously to Advisory Committees, and to members via a place where the information can be easily accessed in both paper and electronic format.

> 19. Information provided to the Superintendent should simultaneously be provided to Employees and Advisory Committees.

Advisory Committees are not needed for Jointly Governed Pension Plans, but the same requirements for information transparency to all members apply.

Role of Regulators

Regulators are responsible for administering pension legislation and ensuring compliance with that legislation. In Nova Scotia, the Superintendent of Pensions, Pension Regulation Division, is responsible for the administration and enforcement of the *Pension Benefits Act*. These responsibilities include ensuring pension plans meet minimum funding standards and minimum benefit standards, eligibility requirements, vesting and locking-in, employer contributions, transfer rights, spousal benefits, prohibitions against sex discrimination and disclosure of information.

Regulators should be neutral as to the format of retirement plans. The choice between these types of plans should be made by employers rather than having a certain type of plan encouraged by government.

Regulators should not attempt to regulate the adequacy of retirement income. While adequacy is a concern, it is not for regulators to decide what is adequate.

> 20. The Regulator should no longer be the only source of appeal prior to making an application to the NS Supreme Court.

Under the current appeal system, the Superintendent of Pensions makes a proposed decision or order. If the plan administrator appeals, a hearing with the Superintendent will be held, the purpose of which is to allow the plan administrator to present all their information. After the hearing, the Superintendent will then review the information and make a decision or order that may, or may not, be different from the proposed decision. If the plan administrator does not agree with the decision, it can be appealed to the Nova Scotia Supreme Court.

The submissions that discussed the role of the Superintendent were unanimous in their view that the current system of the Superintendent reviewing her own decisions was inappropriate. All suggested that a third party should exist to hear appeals from the Superintendent's reconsideration decisions, rather than having to appeal to the NS Supreme Court at that point in the process.

The panel recommends that the PBA be changed to require that appeals from the Superintendent's decision be made to Nova Scotia Labour Relations Board ("NSLRB"). The Province can appoint additional Panel members to assist the NSLRB to deal with pension matters. The NSLRB would have jurisdiction to consider all orders decided by the Superintendent of Pensions without deference to the Superintendent and substitute any decision they think is proper. Any decision of the NSLRB would be subject to judicial review by the Nova Scotia Supreme Court.

Plans for the exclusive benefit of "Connected Persons", as defined by the federal Income Tax Act, should be exempt from regulation under the *Pension Benefits Act*. Connected persons are those who meet one or more of the following conditions. The person:

- owns, directly or indirectly, at least 10% of the issued shares of any class of the capital stock of the employer, or of any other corporation that is related to the employer;
- does not deal at arm's length with the employer; or
- is a specified shareholder of the employer under paragraph (d) of the definition of "specified shareholder" in subsection 248(1) of the *Income Tax Act.*

> 21. Pension plans for the benefit of Connected Persons should be exempt from regulation under the PBA.

Classes

Currently, Nova Scotia legislation includes a list of acceptable classes. This list should be removed. Employers should be allowed to make their own decision on classes of employees, and benefit design for each (subject of course to any agreements arising from collective bargaining and to laws against discrimination that apply to other terms of compensation).

> 22. The list of acceptable classes should be removed from the regulations.

Harmonization

Private sector pension plans are regulated provincially except where they are in federally regulated industries, such as airlines or banks. Given that it is possible to have members of a Nova Scotia pension plan working in other provincial jurisdictions, such a pension plan must be compliant with the pension legislation of multiple jurisdictions.

Nova Scotia has agreements with the federal government and with other provinces that have pension legislation that provide for reciprocal registration, audit and inspection of pension plans. Under these agreements, a pension plan that is subject to the legislation of more than one authority is supervised by the jurisdiction which has the greatest number of plan members. The regulatory body in the jurisdiction of registration applies the rules of other jurisdictions, where applicable. The Canadian Association of Pension Supervisory Authorities (CAPSA) is working on the development of a new reciprocal agreement to replace the current agreement that has been in place since 1968.

While these agreements are helpful, complying with legislation from several jurisdictions can be difficult.

Many submissions noted the preference for complete harmonization of pension legislation across the country, or alternatively, harmonization within the Atlantic provinces. Such harmonization would result in less administrative burden and would provide clarity for plan sponsors. The Panel recognizes the value in such a benefit, however, we also recognize that harmonization on that level is unlikely given the independence of the different jurisdictions.

One advantage of the current diversity is that it allows for innovations (such as recently seen in Quebec) that would never occur if all provinces had to first agree. What matters most is harmonization within individual plans. Nova Scotia legislation should provide that when a plan is administered outside Nova Scotia, and has a majority of members outside Nova Scotia, the province where the plan is administered can regulate Nova Scotia employees in accordance with the rules in the province where the plan is administered.

23. The legislation should allow for a "passport system" for the administration of pension plans.

The Panel does not recommend that Nova Scotia insist on symmetry before instituting this type of passport system. That is, in these types of cases, Nova Scotia should allow other provinces to regulate Nova Scotian employees, but should not expect the other province to reciprocate. Other jurisdictions should be free to follow this type of system or CAPSA's recommendations, or something else entirely. While our recommendation is different from the CAPSA recommendations, we propose that allowing this type of passport system to operate could help to give Nova Scotia a competitive edge, as employers with large plans elsewhere would not be expected to administer Nova Scotia's legislation in addition to the legislation of other provinces.

Member Issues

Grow-in Benefits

Defined Benefit plans are required to include a provision for the member to retire early and receive pension benefits. The benefits may be reduced to account for the extra years the pension is expected to be paid. Some plans provide enhanced early retirement options, modifying or eliminating the reduction for members who meet stated qualification rules.

If a member terminates service with an accrued vested benefit to start at normal retirement age, the plan must provide for a reduced pension payable 10 years before normal retirement date. The plan may or may not provide an earlier age at which the pension may be received on a subsidized basis. The most generous provision would be that a terminating member who has already met the qualifying rules (age and/or service) may receive an unreduced pension starting at the earliest age stated in the plan for active members. At the opposite extreme would be a plan that has no subsidized earlier retirement option for terminated members.

Under the PBA, when a plan is would-up, if the plan provides enhanced early retirement benefits for active members, those benefits must be provided to all members whose age and service at wind-up totals 55 or more.

The Panel recommends changes to these current PBA provisions as follows:

> 24. Eliminate sections 79(1)(a),(b), and (c) which prescribe mandatory grow-in benefits. If a plan chooses to provide these benefits, they should be funded and are equal to all other benefits.

1. The plan terms alone will determine whether or not terminating employees receive eligibility for early retirement subsidies earlier than qualification rules would stipulate.

2. If a plan provides for grow-in rights to enhanced early retirement benefits, these must be included in the assumptions used in the minimum funding calculation, including the valuation of liabilities on plan wind-up.

3. These benefits should receive equal treatment in the case of wind-ups of underfunded plans. That is, if these benefits are included in a plan, on wind-up they should have the same priority of distribution as all other benefits in the plan.

4. Suitable provisions should be made for protecting continuity for those unions that want to see the grow-in benefit continued.

Vesting

Responses to our interim recommendation that vesting in a plan be immediate have been mixed. Those stakeholders that wanted the current vesting rules to remain in place argued that requiring immediate vesting will drive some employers to keep employees out of the plan until they have been employed for a certain period of time. While this is possible, we believe that being vested in a pension plan is desirable and important for members and should be encouraged. Therefore, we stand by our recommendation that vesting in a plan be immediate.

> 25. Vesting in all plans should be immediate.

Unlocking Funds

In Nova Scotia, all pension plan funds, once vested, are locked in, with only three exceptions which are:

(1) In the case of terminal illness;

(2) Requests for small amounts; and

(3) In cases of financial hardship;

The inability to access employer and employee contributions is felt by some to discourage participation in pension plans.

The Panel recommends the following with respect to unlocking of Defined Contribution plans:

(a) Pension funds should remain locked in so long as an individual is an active member of the plan;

(b) It should be optional as to whether a plan permits unlocking;

> 26. The rules for unlocking funds for Defined Contribution plans should be liberalized as outlined.

(c) If a plan permits unlocking, individuals who are at least age 50 should be permitted to unlock either 25% or 50% of their entitlements, on a one-time basis, at or after termination of employment. The unlocked amount could be transferred to a non-locked in RRSP, while the locked in portion could be transferred to a LIRA or locked-in RRSP.

(d) If a plan is silent on unlocking, then 50% unlocking at age 50 or over at the member's election should be the default.

(e) For transition purposes, individuals subject to the current legislation who are 50 or over at the time of the new legislation is enacted should be "grandfathered" under that rule regardless of the option selected for the plan going forward;

(f) The only exception to any of the above rules is that, for Defined Contribution plans, after age 60, members can annuitize their accumulated contributions in whole or in part at any time that they want.

With respect to Defined Benefit plans, unlocking for financial hardship issues should be removed from the legislation. No other changes should be made to the current regime for unlocking for Defined Benefit plans. However, at time of retirement the regulatory restriction would be that up to half of the commuted value could be used for non-traditional retirement income options such as a RRIF or LIF. This would allow the member to integrate with his or her particular circumstances—for example bridging to age 65 .The plan could have stricter rules if it chooses to, but would be responsible for administering them.

> 27. The rules for unlocking funds for Defined Benefit plans should remain unchanged; however, unlocking for financial hardship should be eliminated.

Phased Retirement

In 2007, the federal government made changes to the federal income tax rules that will allow workers to continue working, continue to accumulate pension benefits and receive part of their pensions as well. This change will hopefully, encourage older workers to continue working on a part time basis, before retiring from the work force completely. An amendment to the *Pension Benefits Act* will be required in order to facilitate phased commencement of benefits with the same employer in Nova Scotia.

The Nova Scotia legislation should permit phased retirement—that is, it should not prevent the accumulation of new benefits while receiving a pension. This means that members could continue working at the same or a different job with their employer and accrue additional benefits while receiving part or their entire pension. There would be appropriate actuarial adjustments where needed to recognize the later receipt of the deferred and additional pension benefits. In addition, employers should be able to make their own rules about whether or how they offer phased retirement benefits.

> 28. The legislation should permit but not require, phased retirement.

While plans would not be required to introduce this flexibility, the Panel was advised of situations where this would make sense. Employers could retain valuable and knowledgeable employees rather than forcing them to move to another employer to continue working or hiring them back as sub-contractors without receiving any of the benefits of employees. In turn, this flexibility of arranging their financial affairs would be a significant benefit to employees transitioning toward full retirement.

As mentioned under Ancillary Benefits, postponed retirement options and benefits should be dealt with under Phased Retirement provisions in the proposed amendments to the legislation and regulations.

Promotion

The government should encourage more Defined Benefit plans through more flexible legislation and regulation and through promotional activities. The Panel is of the view that promotion of pension plans should be a function of the Department of Labour and Workforce Development, but separate from the Superintendent's office. While the current role of the Superintendent includes promotion, the resources available do not allow promotion to be addressed at an optimal level. In addition, by removing promotion from the mandate of the Superintendent, more resources could be directed towards the supervision and management of the Act and Regulations.

29. A Promotion Division should be created to promote plans and provide support as outlined.

The mandate of the Promotion Division should include:

(a) Promotion of the province-wide plan;

(b) Encouraging employees to form Advisory Committees; and

(c) Providing training materials and programs in support of Advisory Committees.

Province Wide Plan

As discussed in the Background section of this paper, many significant changes in the past several years have affected pension plans. The percentage of Nova Scotians participating in occupational pension plans has decreased and demographics have changed. Encouraging increased coverage in pension plans and encouraging older workers to continue working is taking on a new importance. Unfortunately, the costs and risks associated with pension plans do not help further either of these goals.

Accordingly, the Panel considered what could be done to help encourage participation in pension plans, and concluded that the Province of Nova Scotia should support the establishment of pension plans available to all employers and employees in the province, which should be administered by an independent agency. The objective of such plans would be to make it easier for employers and employees to participate in an occupational pension plan and to improve retirement security for individuals.

Given that in 2007 there were approximately 57,100 self-employed people in the province, the Panel recommends that self-employed persons be allowed to participate in the plan. Likewise, employees of employers who do not offer pension plans should be entitled to participate.

30. A province wide plan available to all employers and employees should be created and administered as outlined.

The Panel also considered the needs of workers who move from job to job on a regular basis and therefore do not necessarily have the opportunity to contribute to one plan for any length of time. In order to accommodate those individuals, the Panel recommends that the province wide plan allow individuals to transfer the commuted value of their pensions to the new province wide plan. This option would also benefit employees whose employer discontinues the pension plan, or closes its doors. In this way, employees will be able to continue to contribute and/or have their pension funds administered by a competent and cost-effective administrator.

The following are additional recommendations with respect to the province wide plan:

(a) Participation in the province wide plan would not be mandatory, but employers with at least 50 employees, other than those employers who currently have a pension plan, would be required to make a conscious choice to either participate or opt out.

(b) The types of plans available under the provincial plan could include a Target Benefit plan and Defined Contribution plan options for employers of any size in the province. Interested self-employed individuals would be offered a Defined Contribution plan.

(c) A particular benefit and funding version could be constructed for like employer clusters, such as municipalities, or Information Technology firms. It would not be mandatory.

(d) If the Superintendent finds that a plan is poorly managed, he/she should have the power to transfer the assets and management of it to one of the plans offered under the province wide plan.

(e) The province wide plan would be a possible destination for “orphan” accumulations disbursed by plans being wound down.

The provincial agency would be responsible for the pooling of administration and investments, but would not be responsible for the funding risks, nor for any costs of administration or investment management. This plan would be subject to the provisions of the *Pension Benefits Act* and is not a “plan of the Province of Nova Scotia and thereby exempted from the Act”.

These recommendations will make participation easier which will, hopefully, increase coverage and improve retirement security for individuals.

Summary of Recommendations

1. Our focus is first and foremost to create an environment where pension promises will be fulfilled.

   This requires complete transparency of information, so employees (and their representatives) can be fully informed on issues affecting their plan such as funding status, benefit changes, and regulatory issues.

2. The goals of pension legislation should be clear. The Panel's starting point has been to create a list of overarching goals. These goals create a context for addressing complex issues:

   (1) To maximize the likelihood that pension promises are met by:
      i. Isolating pension funds from employer funds;
      ii. Providing vesting protection so that benefits are not lost;
      iii. Providing appropriate rules for the protection and benefit of employees in the event of discontinuation of employment, early or late retirement; and of spouses or beneficiaries in the event of the employee's death, or marriage breakdown.
      iv. Prescribing appropriate minimum funding requirements.

   (2) To ensure that employees have appropriate access to information about their individual benefits;

   (3) To provide transparency of information about all aspects of pension plans to members; and

   (4) To promote and facilitate the implementation and continuation of pension plans.

3. It is helpful to have a list of what the legislation and regulation should avoid:

   (1) Establishing minimal acceptable levels of benefit
   (2) Enforcing equity between plan members (beyond that already applicable to other forms of compensation)
   (3) Favoring one form of pension over others
   (4) Preventing new forms of pensions from being developed
   (5) Increasing regulatory burden either quantitatively or qualitatively
   (6) Discouraging the establishment or continuation of pension plans by unnecessary regulatory burden.

4. The bias in interpreting the Act and regulations should be permissive, not restrictive. If it is not forbidden and does not contradict the spirit of the Act and Regulations it should be permitted.

5. Jointly Sponsored Pension Plans, either single or multi-employer, should be eligible for registration and regulation as a distinct type of plan.

6. Target Benefit Plans should:

   (a) Be available for single employer or multiple-employer groups. (Specified Multi-Employer Pension Plans are an example of this format.);

   (b) Be governed by a Joint Trusteeship of the plan;

   (c) Require the employer(s) to pay at least 50% of the total contributions.

   (d) Be required to use all contributions for provision of benefits and plan expenses.

7. Legislation should be flexible to accommodate new plan designs and funding methods through subsequent regulations.

8. The present solvency funding and going concern valuations should no longer be required for regulatory purposes. In their place an accrued benefit measurement should be required as the minimum funding standard. Specifically:

   (a) Tests of funding adequacy must value **all promises** made.

   (b) On wind-up, plans have to fully fund the benefits promised. The minimum basis for doing so is the proposed valuation standard.

   (c) The rules for minimum funding should be the same for all pension plans subject to the *Pension Benefits Act*.

   (d) No benefit improvements should be allowed if the plan is in deficit, unless they:
   (1) first pay off the deficit in full; or
   (2) pre-pay for the benefit improvement in full; or
   (3) they may pay for the improvement in annual installments, so long as the improvement is considered a hope, rather than a promise, until it is fully funded. In other words, the members must be clearly advised that the benefit improvement will not become a promised benefit until it is fully funded.
   (4) Different rules apply for Target Benefit Plans, including SMEPPs, as described in the next section on Determining and Responding to Deficits.

(e) All valuations must be filed within six months of the effective date of the valuation, with provisions for fines if the timeline is not met.

9. The following rules ensuring minimum funding should apply equally to all plans:

(a) All plans should have an amortization period for deficits over a maximum of ten years, which, would apply to sponsors from the next valuation date onwards.

(b) The financial risks associated with Defined Benefit Pension plans should be mitigated as follows:

(i) A “collar” of 5% should be provided. If a plan is in deficit of 5% or less, then the plan **may** make payments towards the deficit, but is not required to do so. Any deficits over the 5% collar **must** be amortized.

(ii) Actuarial valuations must occur at least once every three years.

(iii) Plans must perform a test each year as of the anniversary of the most recent full valuation. The purpose of these tests would be to provide information on the health of the plan. These tests would update the most recent valuation by calculating:

(1) The impact of the difference between actual and expected return on mean assets; and
(2) The impact of the change in yield on liabilities at the last valuation.

If the test shows that the plan may be in deficit by more than five percent, a full valuation must be performed and must be filed with the Superintendent within six months of the effective date of the valuation, with provisions for fines if this timeline is not met.

(iv) If a plan begins to amortize a deficit over ten years and the next year reveals a lower deficit than expected, then the reduced overall deficit may be amortized over the remaining nine years.

A valuation that shows a reduction in the deficit of the plan will not be accepted unless it is filed within six months of the effective date of the valuation.

(v) If a subsequent valuation, including a valuation required under (iii) shows an increase in deficit, then the previous deficit amortization schedule continues and a new amortization schedule for the new deficit will begin.

(vi) For Target Benefits plans, including SMEPPs, paragraphs (i), (ii) and (iii) apply. For plans where both benefits and contributions are fully adjustable, the plan must, after any valuation showing a funding level of less than 95%, adjust benefits to a level not greater than one that can, using the same methodology in Appendix B, be fully supported by the existing assets plus all future contributions in respect of existing plan members. Benefit improvements can only be made when there is a safety margin of at least 10%. That is, the benefits can be supported by 90% of current assets and future contributions.

(vii) For plans that have both a promised Defined Benefit and a higher target benefit that has been communicated to members, the funding rules for Defined Benefit plan apply to the promised benefit. In addition, the target benefit that is communicated to members can not be greater than the level that can be supported as described in (vi).

(viii) If a deficit requires an increase in contributions, jointly from the sponsor(s) and the members, the increases in contribution rates are not required to be retroactive to the original valuation date. The plans will be allowed up to a year from the valuation date to begin making the increased contributions. However, the end date will be the same, ten years from the valuation date. In other words, if the amortization begins one year after the valuation date, the annual payment will be enough to amortize the total deficit over nine years.

(ix) Smoothing of assets is not permitted.

10. The uncertainty of surplus use and ownership should be mitigated in the following manner:

(a) As with deficits, surplus should be amortized over a minimum of ten years, with interest. Amortization would be through prospective reductions in minimum funding requirements.

(b) As with deficits, there should be a 5% collar for surplus. Any surplus up to 105% minimum funding **cannot** be amortized. Any surplus above the 105% could be amortized.

(c) With respect to active plans, the plan administrator can determine who is entitled to the benefits of any surplus, subject to plan rules, and the impact of collective bargaining. But the result of any choice must be that the

sponsoring employer(s) has paid at least 50% of the net contributions over the previous ten years.

(d) In the case of plan wind-up cash may be withdrawn only after all obligations have been fully met, or in rare cases where the surplus is greater than the present value of ten years worth of contributions (see (f) below). The determination of the division of surplus on wind-up will depend on the share of contributions over the previous ten years. For example, if the sponsor(s) contributed 70% while the members contributed 30%, the surplus would be divided 70-30 as well. However, the division of surplus is always subject to the requirement that the sponsoring employer(s) has paid at least 50% of the net contributions over the previous ten years.

(e) In the case of Defined Benefit plans, those plans that are above the 105% collar may use the surplus to improve benefits. However, the improvement of benefits should not bring the plan below 100%.

(f) Any time the surplus reaches a level greater than the present value of ten years worth of contributions, the surplus above that level must be removed by a cash distribution or improvement of benefits. However, any transaction is subject to the requirement that the sponsoring employer(s) has paid at least 50% of the net contributions over the previous ten years.

11. Ancillary Benefits:

(a) They should be treated like all other benefits, and if they are promised, they should be paid for and sponsors should not be able to have them removed retroactively.

(b) In the case of disability benefits and benefits payable as a result of the member's death before retirement in excess of the required amount (according to the current section 56 of the Act), subject to collective bargaining if applicable, sponsors may reduce or remove them, but only after five years notice to members.

(c) Subsection (f) under Section 48(1) describes "postponed retirement options and benefits in excess of those referred to in subsection (4) of Section 41" as ancillary benefits. Given that the Panel is recommending that Phased Retirement be permitted, this benefit should be removed from the Ancillary Benefit section of the Act and should be dealt with under Phased Retirement provisions.

(d) With respect to all other benefits mentioned under section 48(1), if they are promised benefits under the plan, then these benefits can only be

removed or reduced for future accruals, subject to collective bargaining where applicable.

12. Funding Transition Rules:

(1) Responding to Market Losses in 2008

For many plans the new regime will represent an easing of minimum funding requirements compared with the solvency standards in place today—both because the assumptions are less onerous and because deficit amortization is extended from five to ten years.

Many plans will be under stress because of market losses during 2008. But many tools are available to them to stretch out the response time. Under existing legislation they can do an unscheduled valuation as at, say, June of 2008, in which case the first valuation under the new rules will not occur until mid 2011. If markets have not recovered by then it will clearly be time for action on deficits, which would not be scheduled for completion until 2021. The ten year period is consistent with that offered by other jurisdictions in recognition of market circumstances. We recommend that the new rules should be effective no earlier than the beginning of 2010 but do not recommend any further relief from funding obligations on account of market conditions.

(2) Transitions for New Requirements

Although the new rules will represent relief for most plans, there are two instances where they will impose additional requirements.

(A) Under present regulations municipalities are allowed to defer until 2016 action on solvency deficiencies up to 15% of liabilities, although they would then have to amortize the deferred amount over the next five years.

We recommend that municipalities be allowed to use, for the purpose of deficit amortization calculations on valuation dates between Jan 1, 2010 and Dec 31, 2016 the lesser of:

(1) the deficit amortization determined in accordance with the regulations applicable as described herein to all plans, and

(2) the amount necessary to amortize solvency deficiencies (calculated in accordance with CIA standards) in excess of 15% of liabilities over five years plus the amount necessary to amortize solvency deficiencies

(calculated in accordance with CIA standards) up to 15 % of liabilities over 15 years.

(B) Present regulations have allowed plan sponsors to ignore the cost of inflation-indexing promises in their solvency valuations. The recommended rules require all promises to be funded.

We recommend that for any plans having an inflation-indexing promise as at Dec 31 2008:

(1) For any valuation done under the new regulations prior to Dec 31, 2012 and valuations during the subsequent 24 months, the plan be allowed to use , for purposes of deficit determination , one half of the excess deficit attributable solely to the inflation-indexing promise

(2) For any subsequent valuation the full cost of the inflation promise must be included.

(C) It is worth repeating that these are only **minimum** requirements. Plans which postpone to the latest possible date the additional funding requirements will find the ultimate burden that much heavier.

13. Partial Wind-ups:

(a) The current section on partial wind-ups should be eliminated from the legislation.

(b) The legislation should indicate that upon termination, whether one individual or a group, the member(s) should be able to take the commuted value with him/her, calculated on the same basis as the minimum funding standard. If the withdrawal occurs while the plan is in deficit, the sponsor will be responsible for making up the deficit that was associated with the departing employee(s). This payment must be made within one year of departure, but payment is not required if the total arising in a year is less than 1% of liabilities.

(c) No surplus distribution is required on termination of individuals or groups.

14. If an original plan is closed to new members and there are no new accruals, any surplus in an original plan should be transferable to a new plan according to the surplus rules that are noted in this report.

15. The governance process for investments should be strengthened and the specific investment limits be removed from the regulations as follows:

(a) Schedule I to the Regulations should be continued and expanded.

(b) The expansion of Schedule I should include a separate section on the investment of Defined Contribution plans and other plans where the member is involved in the decision process which will affect the investment results for his/her own pension and thereby the adequacy of pension income.

Sponsors should determine the investment choices to be offered to employees, keeping in mind the following requirements:

(1) The options offered to employees by the sponsor should be chosen prudently;
(2) There should be good communication to the members about the investment choices available;
(3) The member should be provided with information and projection tools in order to calculate the possible results and risks from various choices and the effect on his/her ultimate pension.

Legislation should permit a plan to require default enrolment of members when they become eligible to join the plan and default investment mix selection for members of Defined Contribution plans who fail to make their own selection.

(c) Section III to the Regulations should be removed.

16. “Safe Harbour” provisions should not be included in the regulations.

17. In order to support the development of prudent management of pension plans it is recommended that:

(a) All pension plans must file with the Superintendent of Pensions a copy of their Governance Plan which has been adopted by the Administrator and circulated to the Advisory Committee, Union, or employees, as appropriate.

(b) The governance policy shall speak to issues including:

(i) governance objectives – the administrator should establish objectives for the oversight, management and administration of the plan.

(ii) roles and responsibilities – clearly describe and document the roles, responsibilities, and accountability of all participants

(iii)performance measures – establish performance measures and monitor the performance of participants who have decision making authority

(iv) knowledge and skills – administrator has a duty to apply knowledge and skills needed to meet his/her responsibilities

(v) access to information – the administrator, sponsor, and plan members should have access to relevant, timely and accurate information.

(vii) risk management – establish an internal control framework which addresses the plan's risks.

(viii) oversight and compliance – establish appropriate mechanisms to oversee and ensure compliance with the legislative requirements and pension plan documents and administrative policies

(ix) transparency and accountability – provide for the communication of the governance process to plan members, including how and how often information on benefits will be provided. All information should be provided to members, except for information that will offend FOIPOP by identifying data particular to an individual.

(x) code of conduct and conflict of interest – establish a code of conduct and a policy to address conflicts of interest

(xi) governance review – administrator should conduct a regular review of plan governance

(xii) fiduciary responsibility – administrator has fiduciary and other duties to plan members, and possibly, to other stakeholders.

In the context of governance, members include active members, former members with deferred benefits and retired members or their beneficiaries with benefits still in pay.

(c) The Administrator shall provide a self-evaluation of the governance plan with respect to the criteria listed in (b) and shall certify in its annual filing that the Governance Plan that has been filed is being complied with, and if it has been altered, what are those alterations.

The Superintendent shall review the self-assessments to ensure that suitable content and compliance is being certified. Concerns by either plan members, or the Superintendent, about the governance plan or

compliance to it, could be reviewed by the Superintendent. In the absence of such concerns, the Superintendent would simply file the documents.

(d) Failure to follow filed Governance plans shall be deemed to be evidence of lack of prudence by the Administrator under the provisions of the *Act*.

(e) Employee and/or union involvement in plan administration and governance should be encouraged and any regulatory inhibitions removed.

18. The existing right for employees to create Advisory Committees should be continued and plan sponsors should be encouraged to create Advisory Committees where they do not already exist. Advisory Committees should be provided with the following rights, training and support:

(a) Advisory Committees should be given, simultaneously, any documents that the sponsor files with the Superintendent, subject only to privacy protection for information pertaining to individuals.

(b) Advisory Committees should also be entitled to have reasonable access to plan actuaries, investment managers and other professionals, for explanations of plan documents filed with the Superintendent. The plan would be responsible for funding the costs associated with consulting professionals.

(c) The representatives on Advisory Committees should be representative of the members of the plan. The Committees must include active members and at least one retired member. The Committee may include non-active members with deferred benefits. The number of Committee members should equal 1% of active members in the plan, subject to a minimum of three people and a maximum of ten.

(d) The selection of the Advisory Committee shall depend on whether the plan is in a union or non-union environment. In non-union environments, plan sponsor(s) will choose the members of the Committee that are reasonably representative of the active members, preferably in consultation with the active members. In a union environment, the union will appoint representatives for the union part of the plan, for both active members and union retirees. If the plan has a combination of union and non-union members, the union shall appoint its members in proportion to the number of union members in the plan, with the sponsor(s) selecting the remainder.

(e) Advisory Committees need orientation and training. The sponsor has an obligation to ensure Advisory Committees receive reasonable orientation and training.

19. Access to Information:

    (a) Every formal report or plan document that a sponsor/administrator files with the Superintendent of Pensions should be provided simultaneously to Advisory Committees, and to members via a place where the information can be easily accessed in both paper and electronic format.

    (b) The foregoing applies to all plans regardless of design or governance structure.

20. The role of the regulator of pension plans under the PBA should be clarified and modified as follows:

    (a) Regulators should be neutral as to the format of retirement plans.

    (b) Regulators should not attempt to regulate the adequacy of retirement income.

    (c) The legislation should be changed to require that appeals from the Superintendent's decisions be made to Nova Scotia Labour Relations Board ("NSLRB"). The NSLRB would have jurisdiction to consider all orders decided by the Superintendent of Pensions without deference to the Superintendent and substitute any decision they think is proper. Any decision of the NSLRB would be subject to judicial review to the Nova Scotia Supreme Court.

21. Pension plans for the exclusive benefit of "Connected Persons", as defined by the federal *Income Tax Act*, should be exempt from regulation under the *Pension Benefits Act*.

22. The current list of acceptable classes should be removed from the legislation. Employers should be allowed to make their own decision on classes of employees, and benefit design for each (subject of course to any agreements arising from collective bargaining and to laws against discrimination that apply to other terms of compensation).

23. The Nova Scotia legislation should provide that when a plan is administered outside Nova Scotia, and has a majority of members outside Nova Scotia, the province where the plan is administered can regulate Nova Scotia employees in accordance with the rules in the province where the plan is administered. The Panel does not recommend that Nova Scotia insist on symmetry before instituting this type of passport system.

24. The current PBA provisions for “grow-in” benefits under section 79(1) (a), (b), and (c) should be removed from the Act and the consequential treatment of these benefits will be as follows:

    (a) The plan terms alone will determine whether or not terminating employees receive eligibility for early retirement subsidies earlier than qualification rules would stipulate.

    (b) If a plan provides for grow-in rights to enhanced early retirement benefits, these must be included in the assumptions used in the minimum funding calculation, including the valuation of liabilities on plan wind-up.

    (c) These benefits should receive equal treatment in the case of wind-ups of under-funded plans. That is, if these benefits are included in a plan, on wind-up they should have the same priority of distribution as all other benefits in the plan.

    (d) Suitable provisions should be made for protecting continuity for those unions that want to see the grow-in benefit continued.

25. Vesting in all plans should be immediate.

26. With respect to unlocking of Defined Contribution plans the following rules should apply:

    (a) Pension funds should remain locked in so long as an individual is an active member of the plan;

    (b) It should be optional as to whether a plan permits unlocking;

    (c) If a plan permits unlocking, individuals who are at least age 50 should be permitted to unlock either 25% or 50% of their entitlements, on a one-time basis, at or after termination of employment. The unlocked amount could be transferred to a non-locked in RRSP, while the locked in portion could be transferred to a LIRA or locked-in RRSP.

    (d) If a plan is silent on unlocking, then 50% unlocking at age 50 or over at the member’s election should be the default.

    (e) For transition purposes, individuals subject to the current legislation who are 50 or over at the time of the new legislation is enacted should be “grandfathered” under that rule regardless of the option selected for the plan going forward;

(f) The only exception to any of the above rules is that, for Defined Contribution plans, after age 60, members can annuitize their accumulated contributions in whole or in part at any time that they want.

27. With respect to Defined Benefit plans the following rules restricting unlocking should be as follows:

(a) Unlocking for financial hardship issues should be removed from the legislation.

(b) No other changes should be made to the current regime for unlocking for Defined Benefit plans. However, at time of retirement the regulatory restriction would be that up to half of the commuted value could be used for non-traditional retirement income options such as a RRIF or LIF. This would allow the member to integrate with his or her particular circumstances—for example bridging to age 65 .The plan could have stricter rules if it chooses to, but would be responsible for administering them.

28. Phased Retirement provisions:

(a) Nova Scotia legislation should permit phased retirement—that is, it should not prevent the accumulation of new benefits while receiving a pension.

(b) Sponsors should be able to make their own rules about whether or how they offer phased retirement benefits.

(c) Postponed retirement options and benefits should be dealt with under Phased Retirement provisions in the plan text.

29. Promotion of plans and support for Advisory Committees:

(a) Government should encourage more Defined Benefit plans through more flexible legislation and regulation and through promotional activities.

(b) Promotion of pension plans should be a function of the Department of Labour and Workforce Development, but separate from the Superintendent's Office.

(c) The mandate of the Promotion Division should include:

(a) Promotion of the province-wide plan;

(b) Encouraging employees to form Advisory Committees; and

(c) Providing training materials and programs in support of Advisory Committees.

30. Creation and administration of a province-wide pension plan:

(a) The Province of Nova Scotia should support the establishment of a pension plan available to all employers and employees in the province, which should be administered by an independent agency.

(b) Self-employed persons should be allowed to participate in the plan. Likewise, employees of employers who do not offer pension plans should be entitled to participate.

(c) The province wide plan should allow individuals to transfer the commuted value of their pensions to the new province wide plan. This option would also benefit employees whose employer discontinues the pension plan, or ceases to continue in business.

(d) Participation in the province wide plan would not be mandatory, but employers with at least 50 employees, other than those employers who currently have a pension plan, would be required to make a conscious choice to either participate or opt out.

(e) The types of plans available under the provincial plan could include a Target Benefit plan and Defined Contribution plan options for employers of any size in the province. Interested self-employed individuals would be offered a Defined Contribution plan.

(f) A particular benefit and funding version could be constructed for like employer clusters, like municipalities, or Information Technology firms. It would not be mandatory.

(g) If the Superintendent finds that a plan is poorly managed, he/she should have the power to transfer the assets and management of it to one of the plans offered under the province wide plan.

(h) The province wide plan would be a possible destination for “orphan” accumulations disbursed by plans being wound down.

(i) The provincial agency would be responsible for the pooling of administration and investments, but would not be responsible for the funding risks, not for any costs of administration or investment management. This plan would be subject to the provisions of the *Pension*

Benefits Act and is not a “plan of the Province of Nova Scotia and thereby exempted from the Act”.

Appendices

Appendix A: Definitions

Active member – means a person who is making contributions and/or who is having contributions made on his/her behalf by the plan sponsor to the pension plan fund.

Connected person is defined in subsection 8500(3) of the *Income Tax Regulations* and includes a person who meets one or more of the following conditions. The person:

- owns, directly or indirectly, at least 10% of the issued shares of any class of the capital stock of the employer, or of any other corporation that is related to the employer;
- does not deal at arm's length with the employer; or
- is a specified shareholder of the employer under paragraph (d) of the definition of "specified shareholder" in subsection 248(1) of the *Income Tax Act.*

Contribution holiday – A period when contributions to a pension scheme are put on hold, the most common reason for this being a situation of overfunding.[19]

Former Member – means a person who has terminated employment and is entitled to deferred pension benefits payable from the pension fund.

Defined Benefit pension plan - Plan under which the pension is determined by a formula, usually based on earnings and years of participation.[20]

Defined Contribution pension plan - Plan under which the contributions are determined by a formula, usually based on earnings. The pension is the result of what the accumulated contributions will provide at retirement.

Going–concern funding – Looks at the plan's funded status on the basis that the plan will continue to operate indefinitely.[21]

Grow-in benefit –The provision of enhanced early retirement benefits to pension plan members whose age and service totals at least 55 at the date of either a partial or full plan wind-up if the plan provided subsidized early retirement benefits. These members become entitled to early retirement rights that they otherwise would have grown-into had the pension plan continued.

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[19] OECD Working Party on Private Pensions, 2005, "'Private Pensions: OECD Classification and Glossary, 2005 edition", OECD, Paris

[20] Bruce Cohen and Brian Fitzgerald, *The Pension Puzzle: Your Complete Guide to Government Benefits*, *RRSPs and Employer Plans*, 3d ed. (Mississauga: John Wiley & Sons Canada, Ltd., 2007)

[21] Cameron Hunter, Tom Levy, Michael Mazzuca and H. Clare Pitcher, *Saved from Solvency Funding* (November 2007) Benefits Canada at 57, online: Benefits Canada http://www.benefitscanada.com/pension/db/article.jsp?content=20071129_141520_6144

Jointly Governed Pension Plans - are plans in which both the sponsor(s) and members of the plan participate in making decisions about the plan such as changes to benefit and/or contribution levels.

Members - means active members, former members and retired members.

Net Contributions – contributions reduced by any cash withdrawals.

Partial wind up - means the termination of part of a pension plan and the distribution of the assets of the pension fund related to that part of the pension plan.

Retired member – means a person who has terminated employment and is in receipt of pension benefits payable from the pension fund. It also includes beneficiaries of members with benefits still in pay.

Solvency funding – tests whether a plan has sufficient assets to cover all the liabilities of the plan.

Specified Multi-employer plan - a pension plan established and maintained for employees of two or more employers who contribute or on whose behalf contributions are made to a pension fund by reason of agreement, statute or municipal by-law to provide a pension benefit that is determined by service with one or more of the employers, but does not include a pension plan where all the employers are affiliates of each other.[22]

Sponsor – Establishes the pension plan and supports it financially.

Surplus – is the excess of assets over liabilities.

Target Benefit Plan – a plan in which the plan sponsor sets out the projected benefit and funding for that benefit; when the benefit is not met, either contribution levels change or the target benefit changes.

Vesting – The point at which an employee becomes entitled to a pension provided by employer contributions.[23]

Wind-up – Occurs when a pension plan is terminated and its assets are distributed to provide for the benefits accrued under the plan.

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[22] *NS Pension Benefits Act,* R.S., c. 340.

[23] Bruce Cohen and Brian Fitzgerald, *The Pension Puzzle: Your Complete Guide to Government Benefits*, *RRSPs and Employer Plans*, 3d ed. (Mississauga: John Wiley & Sons Canada, Ltd., 2007)

Appendix B: Details on Minimum Funding

Minimum Funding Standard for Defined Benefit Pension Plans

The following documents the new minimum funding standard for Defined Benefit pension plans.

Application

a. The minimum funding standard is first described for Defined Benefit pension plans. The modifications for Target Benefit plans and other benefit plans are included in sections 8 and 9. The standard does not (and is not intended) to preclude the establishment of funding policies that result in the accumulation of assets or the establishment of contribution rates in excess of prescribed minimums. The minimum funding standard is a combination of the Minimum Funding Current Service Cost, plus the payment(s) for amortizing deficit(s), less deduction(s) for surplus amortization(s).

b. The standard is intended to capture the following principles:

    1) The "minimally funded benefits" are those that have been *accrued* to the date of measurement (i.e., the actuarial valuation date).
    2) Accrued benefits are normally described in terms of *units of pension*, accumulated (or "accrued") over time, plus *ancillary benefits* that may be attached to the basic pension. Ancillary benefits include early retirement subsidies (such as the opportunity to retire before Normal Retirement Age, either without reduction in the accrued pension, if certain criteria are met, or a better-than-actuarial-reduction otherwise), survivor benefits, death benefits, disability benefits, and post-retirement indexing.

2. Method

a. The actuarial cost method to be used is the accrued benefit method. "

b. A "Minimum Funding Current Service Cost" (MFCSC) will be calculated in a manner consistent with the method and assumptions described herein.

c. The determination of actuarial liabilities should be based on the present value of benefits accrued to the valuation date.

d. The MFCSC will be calculated as the percentage of covered payroll required to fund benefits accruing during the one year period subsequent to the valuation date.

e. All ancillary benefits, including indexing and early retirement subsidies, are to be included in the liability calculation. With respect to the latter, early retirement subsidies should be reflected only for individual plan members who have met plan-mandated eligibility requirements as at the measurement (or valuation) date.

3. Assumptions

a. Discount rate(s)

The discount rates will be (for both indexed and non-indexed plans):

1) The rates determined in accordance with the Canadian Institute of Actuaries' (CIA) Standard for Pension Commuted Values , effective as at the valuation date,
2) plus
   a) 0.6% in respect of members who have not yet retired, until normal retirement date, and
      0.3 % thereafter, and
   b) 0.3% in respect of pensioners

b. Mortality

Per the CIA Standard referenced above

c. Terminations

None

d. Retirement

Scale of decrements informed by plan experience, but should assume that not less than 50% of those benefiting from retirement subsidies retire at the most expensive date. Members who have achieved the necessary age and service to receive subsidized early retirement benefits should be assumed to retire immediately after the valuation date.

e. CPI Inflation

Future CPI inflation to average 2%

f. Other

Other assumptions to follow the CIA standard referenced above. Where guidance is not provided the actuary should make a choice consistent with the goal of producing a mildly conservative estimate.

These are intended to produce a mildly conservative basis. They should be specified by regulation (not legislation) and should be periodically reviewed for appropriateness with the local actuarial community.

4. Asset valuation

a. All assets to be valued at market, where available; otherwise by reasonable methods to be prescribed.

b. Where a valuation shows an increase in a deficit or surplus the excess only should be amortized on a new ten year schedule. Where a valuation shows a reduced surplus or deficit, the existing schedule(s) should be proportionately reduced as to amount but retained as to duration. Where a valuation shows a plan that had been in deficit is now in surplus (or vice versa), the pre-existing amortizations should be discontinued.

5. Results

a. Assets > Liabilities x 1.05

Minimum funding = MFCSC minus an amount that will amortize the full excess (with interest) over ten years

b. Liabilities x 1.05 > Assets > Liabilities x 0.95

Minimum funding = MFCSC

c. Assets < Liabilities x 0.95

Minimum funding = MFCSC plus an amount that will amortize the full deficiency (with interest) over ten years

Comments re the results:

In certain circumstances (for example if employees are contributing to the deficit amortization) the commencement of the newly required amortization may be delayed for up to one year from the valuation date. If so the amortization factor becomes the amount necessary to amortize over nine years.

If a surplus is greater than the present value of ten years future contributions, and is therefore potentially in excess of the maximum for purposes of the *Income Tax Act*, the excess necessary to remain within income tax rules should be distributed or used to improve benefits. The administrator can make the choice, but:

1) The employer must always have paid at least half of the contributions net of refunds over the past ten years, and

2) Members must collectively receive in cash or benefit improvements an amount at least equal to their share of net contributions over the past ten years.

6. Sources of funding / influence of funding policies

In recent years, solvency funding has overwhelmed funding policies that were based on the notion of traditional "going concern" funding. This was not always the case, however, and the proposed minimum funding standard does not in any way preclude the development of funding policies that result in the accumulation of assets in excess of what the minimum calls for. In fact, while the environment at the beginning of 2009 makes it easy to dwell on minimum being the *only* requirement, this will not be the case for many plans as either interest rates climb or assets accumulate at a faster rate than liabilities grow, or both – i.e., a reversal of what has happened over the last 15-20 years.

Employers should contribute, on an aggregate basis, at least half of the MFCSC. So when amortizing surpluses the employer(s) can not take a share of the benefit which would result in them having paid less than half of the total contributions over the past ten years.

7. Other elements of funding

a. Terminations

The minimum funding standard proposes to capture the following elements in respect of those who terminate from a Defined Benefit plan:

- For those instances where a commuted value is paid, the commuted value would be calculated in accordance with the valuation standard described herein.

- They should be paid the full commuted value, regardless of the funded status of the plan, ***but*** "top-ups" need to be fully funded within one year of the next valuation date, as opposed to being considered part of a deficit and amortized. A "top-up" is the difference between the full commuted value and the commuted value times the plan's funded ratio as of the most recent valuation date (so, for example, if a plan with a 90% funded ratio paid a commuted value of $100,000 to a member, there would be an obligation on the employer (unless completely jointly funded) to pay $10,000 into the plan, before the determination of surplus or deficit. This is different than current legislation, which would require payment of the balance over not more than five years).This requirement can be ignored if the aggregate payments resulting from it in a year are less than 1% of liabilities.

- Currently, members who terminate more than ten years before the plan's normal retirement date can retain the right to a deferred pension. The Panel is not proposing that this would change.

- Currently, members who terminate within ten years of normal retirement may be compelled by the plan to take a pension (i.e., no commuted value option). The Panel is not proposing that this would change.

b. Partial wind-ups

By calling for the payment of 100% of commuted values on termination, combined with a minimum funding regime that recognizes all benefits including ancillaries and allows for employee participation in contribution holidays there will not be a need for "partial wind-ups."

c. Full Windups

Members not in receipt of benefit payments are entitled to receive the commuted values as described herein. Members who are in receipt of

benefits are entitled to receive the amounts computed using assumed average inflation of 2% but otherwise in accordance with CIA recommendations for windup transfer values.

Employers will continue to be responsible for funding deficits on wind-up. If an employer is bankrupt, the reduction in benefits will be proportionate for all members.

8. Funding of Target Benefit Plans

For plans where both benefits and contributions are fully adjustable, the plan must, after any valuation showing a funding level of less than 95%, adjust benefits to a level not greater than one that can, using the same methodology as described above, be fully supported by the existing assets plus all future contributions in respect of existing plan members. Benefit improvements can only be made when there is a safety margin of at least 10%. That is, the benefits can be supported by 90% of current assets and future contributions.

9. Funding of Other Benefit Plans

For plans that have both a guaranteed defined benefit and a higher target benefit that has been communicated to members, the funding rules for defined benefit plan apply to the guaranteed benefit. In addition, the target benefit that is communicated to members can not be greater than the level that can be supported by existing assets and the future contributions at the current level in respect of existing members.

Appendix C: Transition Rules

(1) Responding to Market Losses in 2008

For many plans the new regime will represent an easing of minimum funding requirements compared with the solvency standards in place today—both because the assumptions are less onerous and because deficit amortization is extended from five to ten years.

Many plans will be under stress because of market losses during 2008. But many tools are available to them to stretch out the response time. Under existing legislation they can do an unscheduled valuation as at, say, June of 2008, in which case the first valuation under the new rules will not occur until mid 2011. If markets have not recovered by then it will clearly be time for action on deficits, which would not be scheduled for completion until 2021. The ten year period is consistent with that offered by other jurisdictions in recognition of market circumstances. We recommend that the new rules should be effective no earlier than the beginning of 2010 but do not recommend any further relief from funding obligations on account of market conditions.

(2) Transitions for New Requirements

Although the new rules will represent relief for most plans, there are two instances where they will impose additional requirements.

(A) Under present regulations municipalities are allowed to defer until 2016 action on solvency deficiencies up to 15% of liabilities, although they would then have to amortize the deferred amount over the next five years.

We recommend that municipalities be allowed to use, for the purpose of deficit amortization calculations on valuation dates between Jan 1, 2010 and Dec 31, 2016 the lesser of:

(1) the deficit amortization determined in accordance with the regulations applicable as described herein to all plans, and

(2) the amount necessary to amortize solvency deficiencies (calculated in accordance with CIA standards) in excess of 15% of liabilities over five years plus the amount necessary to amortize solvency deficiencies (calculated in accordance with CIA standards) up to 15% of liabilities over 15 years.

(B) Present regulations have allowed plan sponsors to ignore the cost of inflation-indexing promises in their solvency valuations. The recommended rules require all promises to be funded.

We recommend that for any plans having an inflation-indexing promise as at Dec 31 2008:

(1)For any valuation done under the new regulations prior to Dec 31, 2012 and valuations during the subsequent 24 months the plan be allowed to use , for purposes of deficit determination , one half of the excess deficit attributable solely to the inflation-indexing promise

(2) For any subsequent valuation the full cost of the inflation promise must be included.

(C) It is worth repeating that these are only **minimum** requirements. Plans which postpone to the latest possible date the additional funding requirements will find the ultimate burden that much heavier.

Appendix D: Examples of Solvency Funding Rules for Universities, Municipalities and Multi-Employer Plans

The following are some examples of how other Canadian jurisdictions handle solvency funding issues for these groups:

- In Ontario, these groups are all subject to solvency rules in the *Pension Benefits Act*, with only one exception. The Specified Ontario Multi-Employer Pension Plan is exempt from solvency funding, but must amortize going concern funding deficiencies over a period of 12 years.

  The Ontario Expert Commission on Pensions has recommended that there be different funding rules for different types of plans. Single employer plans would continue to be required to have both going concern and solvency valuations. Plans whose ratio is 95% or more would be allowed to amortize over eight years. Those plans with ratios at less than 95% would be required to amortize over five years. Specified Multi-employer plans (SMEPPs), Jointly Sponsored Pension Plans (JSPPs) and a new plan design, Jointly Governed Target Benefit plans (JGTBPs) would only be required to have going concern valuations. They would be exempt from solvency but must provide a solvency valuation for information purposes.

- In Manitoba, municipalities and MEPPs are subject to solvency funding rules, but universities, while subject to notice requirements, are permanently exempt from solvency funding payments.

- In Alberta, while universities and municipalities are required to disclose their solvency position, they are not subject to solvency funding. The exemption for universities is conditional on employers guarantee to pay any solvency deficiency on plan termination.

  The Alberta / British Columbia Pension Review recommend that except for a new plan design, a Specified Contribution Target Benefit Plans (SCTBs), all plans should be required to have going concern and solvency valuations. The SCTB plans would require a new going concern plus test as their minimum standard. Amortization of solvency deficits would be over five years but plans can use letters of credit or assets in a pension security fund to satisfy deficiencies.

- In British Columbia, there are four public sector plans, including a Municipal Pension Plan, to which all municipalities belong, and a College plan for instructors at colleges, but not at universities. The plan terms for these plans are determined by a joint board or trustees. Under the trusteeship, employers and employees share equally in the funding, for both current service and unfunded liabilities, and any surplus that may arise. In the case of colleges, if an individual college provides a Defined Benefit plan outside of the College Plan, they are subject to the same funding rules as any other single employer pension plan.

Plans sponsored by universities and Multi employer Defined Benefit plans are subject to the same funding rules as all other Defined Benefit plans in the province. There are no legislated exceptions.

Please see the above bullet in relation to Alberta which notes the recommendations of the joint Alberta / British Columbia Pension Review.

- In Saskatchewan, universities, municipalities and multi-employer pension plans are subject to the same solvency funding rules as single employer plans pursuant to the *Pension Benefits Act*, without exception.

- In New Brunswick, universities, municipalities and multi-employer pension plans are all subject to the same solvency funding rules as a single employer plans with certain exceptions. University and municipal plans can apply for an exemption to solvency funding. Multi-employer plans, like all other pension plans in New Brunswick, can apply to the Superintendent for an extension in the solvency amortization period to a date on or before Dec 31, 2018.

Pension Review Panel

Bill Black

Mr. Black retired in 2004 after nine years as President and Chief Executive Officer of Maritime Life, where he worked for 34 years. He has been Chairman of the Halifax Chamber of Commerce and served nine years on the board of the IWK Health Centre, including two as Chair.

Under Mr. Black's leadership, Maritime Life demonstrated a strong commitment to employees. The company gained a strong reputation for employee relations, appearing every year among the leaders in the Report on Business list of top 50 employers in Canada.

Mr. Black is currently involved in a number of organizations. He sits on the boards of Symphony Nova Scotia, the Canadian Centre for Ethics in Public Affairs, Dalhousie University, the Shaw Group, Standard Life of Canada, Nova Scotia Business Inc., and the Bank of Canada (lead director).

Born in Halifax, Mr. Black graduated from Dalhousie University with a Bachelor of Arts and a Bachelor of Science in 1970, and completed his actuarial training in 1974.

Ronald Pink, Q.C.

A founding partner in the Halifax office of Pink Larkin, Mr. Pink has a legal career spanning more than 30 years. Over the course of his practice, he has represented clients in all aspects of labour and employment law, as well as in matters of employee benefits and pensions.

Mr. Pink was recently voted one of the "Best Lawyers in Canada" for Employee Benefits and Labour and Employment Law.

Mr. Pink has been active in the Canadian Bar Association, serving as President of the Nova Scotia Branch. He has also been active in lecturing and working with other bar societies throughout Eastern Europe and Africa.

Mr. Pink has also served as Chairman of the Continuing Legal Education Committee for the Canadian Bar Association, President of the Continuing

Legal Education Society of Nova Scotia and he is a founding vice president of the Canadian Association of Labour Lawyers. He is also a Director of the Canadian Bar Insurance Association and a Director of Invest in Kids. In 2008, he was appointed as a member of the Litigation Counsel of America, as well as being appointed Chair of the National Hockey League Players' Association ("NHLPA") Advisory Committee.

In 1970, Mr. Pink received a Bachelor of Arts degree from Acadia University. He received a Bachelor of Laws degree from Dalhousie University in 1973 and a Master of Laws degree from the University of London in 1974. He was appointed Queen's Counsel in 1991 and was also named a Fellow of the American Trial Lawyers' Association in 2006.

Dick Crawford

Mr. Crawford retired as President and Chief Executive Officer of Maritime Life in 1995, after 13 years of service. He was a Director at Maritime Life from 1982-2004 and served as Chairman of The Board from 1997 – 2004. He was also Director of the Halifax International Airport Authority from 1997 – 2000.

Mr. Crawford has served his community in other capacities; as a member of the Board of Governors and as Chair of the Investment Committee at Dalhousie University. Mr. Crawford was also President of the Canadian Institute of Actuaries.

Mr. Crawford graduated from the University of Toronto with a Bachelor of Arts (Honours) for Math, in 1956. He completed his actuarial training in 1965.