

Submission by the Canadian Institute of Actuaries to the Alberta-British Columbia Joint Expert Panel on Pension Standards

March 2008

Document 208018

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Preface

The Canadian Institute of Actuaries (CIA) is pleased to present its recommendations for sustaining and improving the pension system to the Alberta-British Columbia Joint Expert Panel on Pension Standards (the Panel).

The CIA establishes the Rules of Professional Conduct, guiding principles and monitoring processes for qualified actuaries, all of whom must adhere to the profession's Standards of Practice and Guiding Principle 1, which states that the public interest is paramount. The CIA also assists the Actuarial Standards Board in developing Standards of Practice applicable to actuaries practising in Canada, including those standards governing the actuarial valuation of pension plans.

The CIA continuously reviews its standards related to Defined Benefit pension plans and new Standards of Practice are being developed by the Actuarial Standards Board for the funding of pension plans and for determining the commuted value of a pension benefit.

Recently, the CIA has made a number of recommendations for changes to the regulatory framework for pension plans in Canada, which we believe are relevant to the work of the Panel. These include the Canadian Institute of Actuaries' Prescription for Canada's Ailing Pension System, submissions to the House of Commons Standing Committee on Finance, and Ontario Expert Commission on Pensions. These documents are appended to this submission. A summary of the profession's recommendations made in these submissions follows:

Helping Canadians build adequate retirement income in an optimal way is a critical public policy issue. Given the importance of Defined Benefit pension plans in the provision of retirement income to Canadians, changes to the retirement system are needed to facilitate the maintenance of existing plans and encourage increased coverage by such plans. **The current and future financial security of retired and retiring Canadians is being threatened by the decline of Defined Benefit pension plans.**

In our view, the governments should:

- **Require all Defined Benefit pension plans to establish and maintain a Target Solvency Margin to enhance benefit security.** The level of the Target Solvency Margin would be related to the risks faced by the plan. Plan sponsors would be required to continue making current service contributions, even if the plan had assets in excess of the solvency liabilities, as long as plan assets are less than the sum of the solvency liabilities and the Target Solvency Margin.
- **Permit the use of a Pension Security Trust.** The Pension Security Trust would be complementary to, but separate from, the regular pension plan fund and would be used to increase funding levels and enhance benefit security for plan members. If the tax-deductible contributions made to the Pension Security Trust were subsequently found not to be needed to fund benefits, they would be released back to the plan sponsor.

- **Enact flexible legislation that encourages innovation in plan design and financing arrangements, and promotes the growth of Defined Benefit pension plans.** Again, enabling legislation needs to be flexible to allow for innovative measures such as Pension Security Trusts and letters of credit.
- **Enact pension legislation that permits the use of letters of credit for solvency amortization payments.** Allowing the use of letters of credit for this purpose would provide plan sponsors with additional flexibility without decreasing the security of the plan member benefits. Letters of credit could be held as an asset in the Pension Security Trust.
- **Change the way pension plan wind-ups are processed to address practical difficulties for annuity purchases.** The annuity market in Canada is not large enough to handle significant one-time annuity purchases, and some types of annuities are difficult to purchase (e.g., indexed pensions). Therefore, plan wind-ups that occur will likely be protracted over time, exposing the plan to additional market risk. Allowing alternative methods of settling plan obligations on wind-up must be explored.
- **Require annual actuarial valuations for plans whose solvency ratio is less than 100 percent.** Plans with solvency ratios above 100 percent would continue to conduct valuations every three years. This represents a reasonable balance between the desire for more timely intervention when a plan is headed into financial difficulty and the concern about excessive administration costs.
- **Amend the legislation and policies to facilitate adjustments in pension plan designs and workplace policies to deal with increasing longevity and workforce planning.** In particular, pension legislation should be changed to accommodate phased retirement policies.
- **Explore alternative ways of protecting benefits in wind-ups of underfunded plans by insolvent employers.** Look at what other jurisdictions and countries are doing, for example, the availability and usage of privately managed insolvency guaranty schemes or insurance contracts for this purpose. In the meantime, unfunded pension liabilities should be given priority similar to that of unpaid wages in bankruptcy proceedings.
- **Require plan sponsors to establish a formal funding policy for Defined Benefit pension plans.** The written funding policy would: a) define the roles of the plan sponsor and the actuary; b) address both going concern and wind-up bases; and c) address timing of valuations, giving specific consideration to benefit security and stability of contributions. This recommendation would increase transparency and provide stakeholders with an enhanced understanding of the funded status of the plan and the associated risks.
- **Take the lead in coordinating the development of pension legislation in Canadian jurisdictions.** Currently, moving pension issues forward on to the national agenda is impossible as the respective ministers responsible for pension matters, provincially and federally, never meet. For example, responsibility for the pension file falls under the Minister of Finance in only three provinces.

- **Eliminate partial plan terminations.** This would not only eliminate the surplus distribution issue on partial termination but would also remove the administrative and cost burdens related to partial terminations. However, if partial plan terminations are maintained in the pension legislation, the government should more clearly specify the criteria for any special situations in which full vesting rights must be provided.

Summary of CIA Recommendations in this Submission

- Alberta and British Columbia should make legislative and regulatory changes that:
 - Clarify the rules for surplus ownership and utilization that recognize plan sponsors' right to, and access to, Defined Benefit pension plan surpluses;
 - Clarify that documents establishing pension plan funding vehicles are documents of the plan, subject only to the provisions of the *Pension Benefits Acts* and regulations;
 - State explicitly that to the extent of any inconsistency with the common law, the provisions of the *Pension Benefits Acts* and regulations are paramount and supersede the common law; and
 - Require that all plans whose solvency ratio is less than 100% be required to conduct actuarial valuations annually.
- The CIA would be willing to have further discussions with the Alberta and British Columbia authorities to flesh out the possibilities of encouraging more plan coverage by providing more flexibility in plan design and financing arrangements.
- Defined Benefit pension plans should be required to establish and maintain a Target Solvency Margin to enhance benefit security. A task force should be set up with representation from pension regulators, the federal Department of Finance and the CIA to review the CIA's research on appropriate margins for solvency valuations and to establish the Target Security Margin framework.
- With a view to increasing benefit security, we invite the Alberta and British Columbia governments to encourage the federal government to change the tax rules in order to allow Defined Benefit pension plans to maintain reasonable funding margins before contribution holidays are required (e.g., allowing developing surpluses that are the greater of two times the Target Solvency Margin or 25% of the going concern liability).
- Legislation should be introduced to:
 - Enable Pension Security Trusts as an innovative way to facilitate improvement in benefit security.
 - Allow a pension plan to settle a larger proportion of its obligations at plan termination through the payment of lump sum commuted values than is allowed under current legislation in order to accommodate the limited group annuity market in Canada.
 - Require plan sponsors to establish a written funding policy for Defined Benefit pension plans in order to promote clear objectives and transparency.

- The required annual disclosure by plan administrators to plan members should be expanded to include the key elements of the funding policy, as well as the investment policy and the current funded status of the plan.
- We recommend that governments provide the basics of financial literacy in high school, and encourage employers and financial institutions to become more intimately involved in the education of plan members, potentially involving government incentives and effective safe harbour protection.
- We encourage Alberta and British Columbia to take the lead in getting all pension regulators and governments in Canada to work together at defining new improved pension standards that are consistently applied across Canada and reflect the need for increased pension coverage, the risks assumed by the various stakeholders and the members' concerns about better benefit security. The CIA would be pleased to participate in discussions on these crucial issues.
- The CIA believes that retirement savings ought to be on the national agenda and has encouraged the federal Minister of Finance to initiate a meeting of all provincial and territorial ministers responsible for regulating pensions in order to establish a common framework for pension legislation to resolve the coming challenges to the retirement savings system. We encourage British Columbia and Alberta governments to strongly support this initiative by promoting it among the other provinces and with the federal government.

Issues Addressed In Our Submission

Our submission focuses on those aspects of the Panel's mandate that are most directly related to the role of actuaries in the establishment and management of pension plans, and for which we believe the Institute has unique expertise to offer meaningful input to the Panel's deliberations. In Chapter 1 of our submission, our comments are organized into three main themes:

1. Improving the regulatory and business environment for pension plans in Alberta and British Columbia.
2. Putting Defined Benefit pension plans on a sounder financial footing.
3. Enhancing public understanding of the "pension promise."

In Chapter 2, we provide input to each question posed by the Panel in its consultation paper.

CHAPTER 1 – MAIN CIA RECOMMENDATIONS FOR IMPROVING OUR PENSION SYSTEM

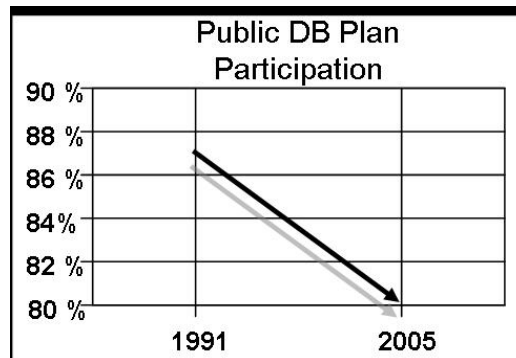
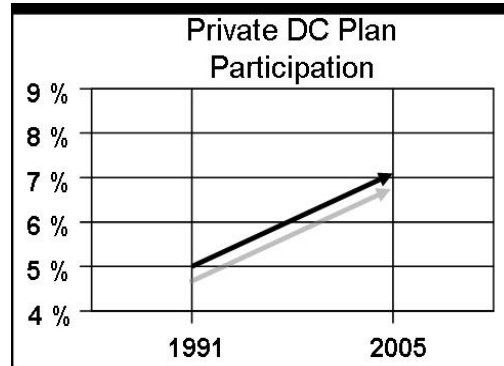
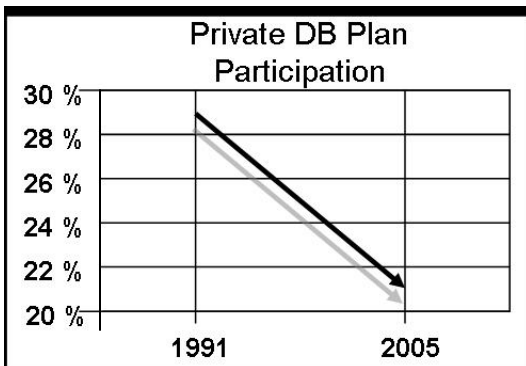
1. Improving the Regulatory and Business Environment for Pension Plans

Defined Contribution plans, Defined Benefit plans, and other arrangements are all part of a strong and vibrant retirement savings system. Weakness in any one element puts pressure on the others. The CIA believes that **the future of Defined Benefit pension plans is at risk** unless changes are made to the pension system.

Our concern is reflected in the percentage decline of workers covered by Defined Benefit plans. There are a number of reasons for this trend, including Canada's patchwork of regulations, legal decisions, tax rules and changes in accounting standards. These problems have been compounded over the recent past due to:

- low interest rates;
- increasing longevity;
- volatile market yields; and
- the uncertainty regarding contribution holidays and plan surplus ownership and utilization.

1.1 Importance of Occupational Pension Plans and, in particular, Defined Benefit Pension Plans To Canadians



The graphs above show that in the private sector, participation in pension plans has decreased from 34% in 1991 to only 28% in 2005. The growth of Defined Contribution plans has not offset the decline in Defined Benefit plans. Moreover, public sector Defined Benefit pension plan participation also declined in the same time period.

Both the adequacy and security of retirement income are seriously threatened by the decline in coverage by all types of occupational pension plans. In addition, a Defined Benefit pension plan provides security that cannot be found in Defined Contribution pension plans or RRSPs. The pension benefit is pre-defined, usually as a percentage of pre-retirement salary or as a fixed rate per year of service. While plan members may provide a defined level of contributions to these plans, the plan sponsor undertakes to contribute at whatever additional level is necessary to fund the promised benefits. Saving and improving Defined Benefit pension plans is a better choice for Canadians than allowing their steady erosion.

Defined Benefit pension plans are an important component in the overall retirement system and are in the best interests of Canada and Canadians for a number of reasons:

- a) ***Greater predictability for plan members.*** Defined Benefit pension plan members have a good sense of what they will receive in retirement, making planning and saving for the future easier and reducing uncertainty.
- b) ***More security and less risk to plan members.*** Individuals in an ongoing Defined Benefit pension plan face lower risks related to changing interest rates, longer than expected longevity and volatility of market returns.
- c) ***Better workforce management.*** Defined Benefit pension plans help employers retain good employees and they can be a tool to help employers better manage their workforce (e.g., enhance early retirement or provide incentives to delay retirement).
- d) ***Higher investment return.*** By having larger pools of money to invest and, importantly, longer investment time horizons, a more aggressive, diversified and informed investment strategy with lower management fees can be used. The higher yields and lower administration costs result in greater value for dollars invested in Defined Benefit pension plans compared to Defined Contribution pension plans over the long run.
- e) ***Greater economic benefit to society and the economy.*** Recently-retired Bank of Canada Governor David Dodge supports Defined Benefit pension plans. He believes that they promote economic efficiency by allowing a better allocation of savings and they provide efficiency gains for financial markets. He has stated that managers of Defined Benefit pension plans have both the ability and desire to invest in the kinds of assets that the average individual investor might not normally consider. Such managers have a superior knowledge of financial markets and of the associated risks that make them willing to invest in alternative asset classes, and Defined Benefit pension plans invest over very long time horizons so they can finance large investment projects at competitive rates of return. An example would be investment in critical infrastructure to support Canada's future production capacity.

1.2 Removing Uncertainty About Surplus Ownership And Utilization

Plan members expect reasonable assurance of the delivery of the promised benefits, which is achieved by the level of funding of the plan. **Plan sponsors seek reasonable predictability of costs** and will resist making contributions to pension plans to increase the solvency, and hence security of plan members' benefits, when they do not feel they have control over any amounts that may turn out to be excess to those needed to provide the promised benefits.

A critical issue that must be resolved for Defined Benefit pension plans is surplus ownership and utilization. The current uncertainty surrounding plan surplus ownership and utilization does not encourage higher levels of funding. Consequently, it has a detrimental effect on benefit security. This uncertainty may indeed be one of the most significant forces driving the decline in Defined Benefit pension plan coverage.

Many plan sponsors have been reluctant to fund their pension plans beyond minimum legislative requirements because they are uncertain whether they will have access to any surplus funds that may subsequently arise. In most single-employer Defined Benefit pension plans, the plan sponsor backstops the funding risks. When economic conditions are unfavourable and funding deficits occur, whether measured on a going concern or wind-up basis, the plan sponsor must increase contributions to the plan. When conditions turn favourable, plan sponsors often feel that they should control the use of funding surpluses, whether through contribution holidays, surplus reversions or benefit improvements. However, the surplus is often claimed by the plan members upon a partial or full plan wind-up, even in cases of clear surplus ownership by the plan sponsor according to plan documents. This imbalance is perceived by plan sponsors as unfair, and it discourages the secure funding of Defined Benefit pension plans, decreasing the security of members' pension benefits.

We believe that Alberta and British Columbia should make legislative and regulatory changes that:

- Clarify the rules for surplus ownership and utilization that recognize plan sponsors' right to, and access to, Defined Benefit pension plan surpluses;
- Clarify that documents establishing pension plan funding vehicles are documents of the plan, subject only to the provisions of the *Pension Benefits Acts* and regulations; and
- State explicitly that to the extent of any inconsistency with the common law, the provisions of the *Pension Benefits Acts* and regulations are paramount and supersede the common law.

These changes should override legal precedents that have recently been established particularly where the plan documentation is silent on these issues, but they should also recognize that existing contracts or agreements between the plan sponsor and plan members will need to be respected. Removing this uncertainty surrounding surplus ownership and utilization will go a long way towards eliminating unanticipated costs to plan sponsors and will increase the palatability of sponsors to fund on a more secure basis, thereby enhancing benefit security.

1.3 Mergers, Splits and Asset Transfers

When one employer sells a business unit to another, and the employees of that business unit participate in a pension plan for all of the vendor's employees, it is often necessary for the purchaser to establish a pension plan and assume responsibility for the past service obligations of the vendor. Assets are transferred from the vendor's pension plan to a new or existing plan sponsored by the purchaser. Ideally, the basis for determining the amount of the asset transfer is fully defined by the purchase and sale agreement. Similarly, an employer may merge its operations with another employer and it may become necessary to merge the respective pension benefits into one new plan that covers all employees of the new entity.

The legislation and approval policies should continue to recognize the reality that these business transactions occur in a variety of forms and that time is usually a factor.

1.4 Innovative Designs and Financing Arrangements

The CIA encourages innovation in plan design and financing arrangements that promote the growth of pension plans. Often, pension legislation, the *Income Tax Act* or interpretations of them have excluded some good plan designs or features. Such innovations, if allowed, may encourage more pension plan coverage by providing increased flexibility.

Three examples of features that could be considered are:

- Partial or full payment of accrued benefits under phased retirement agreements;
- Express benefit accruals in the form of a number of "shares", which would increase in value during the members' working careers through an excess interest approach;
- Cash balance plans (used extensively in the United States).

Other designs that may offer additional flexibility to plan members and assist employers in attracting and retaining employees would be welcome.

Any measure that can alleviate operational costs or mitigate risks for organizations sponsoring pension plans should be considered, especially for small plans.

The CIA is looking forward to having discussions with the Alberta and British Columbia authorities to flesh out the possibilities. In any event, less rigid legislation and regulations at provincial and/or federal levels would be required to allow flexibility while retaining security of members' benefits under any of these, or other, innovative concepts.

2. Putting Defined Benefit Pension Plans on a Sounder Financial Footing

The goal of funding Defined Benefit pension plans is the systematic accumulation over time of dedicated assets that, without recourse to the plan sponsor's assets, secure the plans' promised benefits. To continue to be successful, *Defined Benefit pension plans must:*

- a) provide plan members with reasonable confidence that the promised benefits will be paid; and*
- b) offer plan sponsors a reasonable predictability of costs.*

Confidence on the part of plan members requires both adequate funding of the benefits and the development of an environment in which plan sponsors are encouraged to maintain and appropriately fund Defined Benefit pension plans. Predictability of costs requires the proper measurement and appropriate reporting of funding requirements and of the associated risks, and an enabling regulatory environment. There must be an equitable treatment of the consequences of risks undertaken, which is clearly articulated and understood by all stakeholders.

2.1 Target Solvency Margin

One method of achieving more secure funding of benefits would be for plans in a surplus position to maintain a portion of that surplus as a Target Solvency Margin, the target percentage by which the assets of a plan should exceed the liabilities on a solvency valuation basis. The amount of the Target Solvency Margin would vary according to the potential volatility of a plan's funded position,¹ thereby ensuring more secure funding based on the level of risk of the plan.

The implementation and ongoing monitoring of the Target Solvency Margin should not involve overly high complexity, cost and work. The development of such a margin should balance the need to accurately reflect the plan's risk exposure with the need for simplicity, recognizing the small size of some plans.

The Target Solvency Margin would determine when a plan sponsor could take a contribution holiday. Unless the sum of the assets in both the regular pension fund and the Pension Security Trust (see below) – including the face amount of the letter of credit, if applicable – exceeded the solvency liabilities by at least the Target Solvency Margin, the sponsor would be required to continue making current service contributions (i.e., contributions determined in accordance with the going concern valuation).

For Multi-Employer Pension Plans (MEPPs) in which the employer contributions are not negotiated, and the pension “deal” is for a defined benefit in which the individual contributing employers are responsible for the risk of unfunded liabilities, solvency deficiencies and increases in the normal cost, the Target Solvency Margin concept must also be considered. In Chapter 2 of this submission, we provide comments on special rules that should be explored for Negotiated Cost Defined Benefit (NCDB) plans in which the employer contributions are negotiated and the pension deal is for the negotiated contributions combined with a target benefit (not a promised benefit) established by a board of trustees.

In November 2007, the CIA published a research paper on the determination of appropriate provisions for adverse deviations in hypothetical wind-up and solvency

¹ Risk-based solvency through a Target Solvency Margin is a concept already used by governments to ensure the security of other risk-bearing financial institutions. Some Defined Benefit pension plans are subject to greater volatility than others, partly as a result of the asset mix of the plan. A pension plan invested mostly in high quality bonds would typically have a lower risk than one with an asset mix with high percentages of Canadian and foreign equities. Other risk factors include the demographic profile of the plan membership, the investment policy and the associated asset/liability mismatch (i.e., the extent to which the cash flows of the assets deviate from the cash flows of the liabilities). Hence, each plan should have a Target Solvency Margin established based on its specific risk factors and its exposure to volatility. Establishing Target Solvency Margins for plans that have different risks will create a risk-based approach to plan funding.

valuations. We expect that the Québec supervisory authorities will reflect this research paper in the development of their rules mandating solvency provisions for adverse deviations. We acknowledge that amendments to the income tax legislation may also be required to accommodate the Target Solvency Margin concept. ***We recommend that a task force be set up with representation from pension regulators, the federal Department of Finance and the CIA to review this research and establish the Target Security Margin framework.***

As seen in the current decade, the financial position of Defined Benefit pension plans can experience significant fluctuations within a relatively short time-frame. It would be desirable to allow these plans to maintain a surplus level that would be sufficient to ward off against negative experience. The maximum surplus level allowed under the current federal tax rules is too low to provide adequate financial protection. With a view to increasing benefit security, ***we invite the Alberta and British Columbia governments to encourage the federal government to change the tax rules in order to allow Defined Benefit pension plans to maintain reasonable funding margins before contribution holidays are required (e.g., allowing developing surpluses that are the greater of two times the Target Solvency Margin or 25% of the going concern liability).***

2.2 Pension Security Trust

The Target Solvency Margin would work best in tandem with a **Pension Security Trust**, a separate sponsor-funded and sponsor-owned trust, or letters of credit (discussed in section 2.3). Plan sponsors could pay the additional contributions required to meet solvency funding requirements into the Pension Security Trust or use a letter of credit for this purpose. **Use of the Pension Security Trust and/or a letter of credit instead of the regular pension fund would ensure that any part of the Target Solvency Margin, not ultimately needed to provide plan benefits, would be accessible by the plan sponsor.**

We believe that most plan sponsors would be willing to fund a Defined Benefit pension plan more securely, thereby improving benefit security for the members, if they knew that they could access any surpluses that might arise from their excess contributions. This confidence would encourage plan sponsors to continue their Defined Benefit pension plans or to start new ones.

We recommend that legislation² be introduced to enable Pension Security Trusts as an innovative way to facilitate this improvement.

Plan sponsors would be able to contribute to the Pension Security Trust, which would be complementary to the regular Defined Benefit pension plan trust fund. The assets would be invested in a manner similar to the regular pension plan trust fund, and would be held as a side fund by the trustee and custodian. Unlike the pension plan trust fund, however, the Pension Security Trust would hold plan sponsor contributions only and would be “owned” by the plan sponsor.

Solvency deficiency payments would be placed in the Pension Security Trust. Contributions arising from going concern valuations would go into the regular pension fund. The Pension Security Trust could also be used by plan sponsors who wish to

² To allow Pension Security Trusts will mean changes to both the *Income Tax Act* and provincial legislation.

contribute more than the minimum required under the going concern valuation to strengthen the funding of the plan. If subsequent valuations showed that some of the assets in the Pension Security Trust are not required to pay plan benefits, then the excess could be released back to the plan sponsor.

The assets held in the Pension Security Trust fund would be included in the value of assets for the purposes of the solvency actuarial valuation and, in case of plan wind-up, the monies held by the Pension Security Trust may be refunded to the sponsor to the extent not necessary to cover any excess of the wind-up liabilities over the assets in the regular pension fund. The pension plan would be granted a priority claim to the Pension Security Trust fund in the event of the sponsor's insolvency, ahead of other creditors, up to the amount needed to satisfy plan wind-up obligations.

2.3 Letters of Credit

We applaud Alberta for adopting legislation that permits the use of letters of credit to guarantee solvency deficiency amortization payments. We recommend that British Columbia adopt amendments to its legislation to allow this practice.

Letters of credit provide plan sponsors with additional flexibility without decreasing the security of the benefits accrued by the plan members. They provide plan sponsors the opportunity to better manage their cash flow and utilization, which are important considerations in the current environment of worldwide competition and the struggle for increased efficiency. Instead of paying additional contributions to the pension fund, the plan sponsor will be able to provide a letter of credit whose amount can fluctuate according to the economic context and the financial health of the pension plan.

The letter of credit could be held as an asset in the Pension Security Trust. The face amount of the letter of credit would be considered a plan asset and taken into account for actuarial valuation purposes. It should remain in effect unless it is reduced or cancelled by paying an equivalent contribution into the Pension Security Trust or having a surplus on a solvency basis. Upon plan termination, the letter of credit would be usable only up to the amount of any actual deficiency.

2.4 Solvency Valuations

Security of plan benefits is promoted by actuarial valuation results on a plan wind-up basis and, typically, contribution stability is promoted by valuation results on a going concern basis. Actuarial valuation reports should highlight these two key objectives – the security of benefits in the event the plan is wound up, and the stability of contributions if the plan is continued for the long term.

However, in recent years the solvency valuation results have had a significantly increasing influence on the level and stability of contribution requirements for a variety of reasons, including:

- Low interest rates, and concomitant higher annuity purchase rates and commuted values;
- Volatile investment markets, which can cause considerable short-term swings in the market value of assets recognized for solvency purposes;

- Increasing proportions of retiree liabilities (including those eligible for early retirement and other members with associated “grow-in” rights) in many plans, due to general aging of the workforce, increased longevity, closing of the Defined Benefit portion of the plan to new entrants upon conversion to a Defined Contribution plan and, particularly for certain multi-employer plans, employment in a declining industry;
- “Front-loaded” legislative contribution requirements, since solvency deficiencies must be amortized over a five-year period.

We note that the group annuity market in Canada is limited. For many plans, it is highly unlikely that the plan administrator would be able to purchase annuities for all of its retirees (including those eligible for early retirement) in one transaction upon plan termination. In fact, it could take many years before all the retiree obligations of the terminating plan could be satisfied through the purchase of annuities. Further, some annuities are difficult, if not impossible, to purchase (e.g., indexed annuities).

One suggestion for dealing with this issue might be to **allow the pension plan to settle a larger proportion of its obligations through the payment of lump sum commuted values than is allowed under current legislation.** For example, a plan might be permitted to settle all liabilities for active members by paying lump sum settlements (rather than giving such members a choice between a deferred annuity or a lump sum), while retired members might be offered a choice between an immediate annuity or a lump sum. The CIA is willing to conduct further study into what commuted value standards would be appropriate under these circumstances.

In practice, plan wind-ups tend to be conducted in multiple transactions over an extended period of time; this process exposes the plan to extra market risk, because it adds uncertainty about the ultimate cost to settle the plan’s obligations. However, for plans that have accumulated a Target Solvency Margin, the margin would serve as a buffer against this market risk for the duration of the wind-up process, thereby minimizing the likelihood of additional contributions by the sponsor or loss of benefits by members.

2.5 Frequency of Actuarial Valuations

Under current Alberta and British Columbia legislation, actuarial valuations must be conducted at three-year intervals, except that annual valuations are required for plans registered in Alberta with funding or solvency ratios less than 85%. As recent market experience has demonstrated, the solvency positions of pension plans can change very quickly and dramatically, and some observers argue that a three-year valuation interval means that the sponsor of a plan whose financial position is deteriorating will respond too slowly to ensure a reasonable level of benefit security for plan members. On the other hand, actuarial valuations impose a cost to the plan or to the sponsor, and excessive requirements for frequent valuations can be a significant financial burden, particularly for smaller plans.

We suggest that the Panel consider recommending that all plans whose solvency ratio is less than 100% be required to conduct actuarial valuations annually. A plan would revert to the triennial valuation interval once the insolvent financial position is eliminated. This would be consistent with the legislation that exists in other jurisdictions, and, in our view, represents a reasonable balance between the desire for more timely

intervention when a plan is headed into financial difficulty and the concern about excessive costs. For plans with solvency ratios greater than 100%, a requirement to maintain a Target Solvency Margin would provide some degree of protection to plan members against unfavourable experience before the next triennial valuation is conducted.

2.6 Managing Longevity Risk

While increasing longevity is certainly a positive development for Canadian society overall, it also means that providing adequate lifetime income to retirees will become an ever greater challenge. For sponsors of Defined Benefit pension plans, pension payments must be extended to increasingly higher ages, raising the total cost of the plan. **For employees accumulating retirement savings in Defined Contribution pension plans or personal RRSPs, the level of retirement income at a given retirement age will decrease as longevity increases; they will have to either save more, retire later or enjoy a poorer retirement lifestyle.**

Over the long term, the only way for society to deal with increasing longevity is gradually to adapt its workforce policies and its retirement income arrangements to the new reality. This will require some combination of raising retirement ages, reducing benefit levels, or raising costs to plan sponsors or to members. The relative emphasis on each of these measures will depend on the circumstances within each employment setting or each sector of the economy.

In practice, some of these measures might be very contentious and difficult to implement. For example, raising the normal retirement age at which a worker qualifies for a full pension might be resisted particularly strongly in some workplaces. On the other hand, it might be argued that one of the causes of increasing longevity is an improvement in overall public health, leading to an increasing ability for older workers to remain in the workforce longer than they could in the past. Faced with a choice between delaying their retirement age or receiving a lower pension to keep plans affordable, many workers might be willing to accept a delay in their retirement age, knowing that they will need to extend the productive stage of their lives if they want to keep a reasonable standard of living into their extended retirement years.

As plan sponsors and workers adapt to the new environment, it is important to keep up with trends in mortality and longevity, and for actuaries to ensure that the most realistic available demographic assumptions are used in determining the estimated future costs of pension benefits. This will enable informed decision-making in the process of modifying pension plan provisions or workplace policies. **The Institute is committed to ongoing reviews of professional standards for actuaries**, including updates to guidance on the selection of appropriate mortality assumptions for the valuation of pension benefits. The Institute is supported by research from the Society of Actuaries, which sponsors regular studies of mortality experience among populations of active workers and group annuitants in the United States and Canada. The Society of Actuaries is an actuarial education and research organization based in Chicago, many of whose activities are jointly sponsored by the CIA.

To give some perspective on the estimated financial effect of increasing longevity, relative to other factors affecting the costs of a pension plan, we performed a series of

calculations showing the estimated cost of a pension payable to a 65-year-old and the effect of projected improvements in mortality over a period of 50 years. The results are presented in the following table. For each gender, we have assigned a “relative cost” of 100 to represent the present value of an immediate pension that starts to be paid to an individual who attains age 65 in the year 2010.

	Relative cost ³ of immediate pension	
	Male	Female
Age 65 in 2010 (base case)	100	100
Age 65 in 2020	103	101
Age 65 in 2030	106	103
Age 65 in 2040	109	104
Age 65 in 2050	112	105
Age 65 in 2060	114	107
Age 65 in 2010; delay retirement to age 66	94	94
Age 65 in 2010; delay retirement to age 67	89	89
Age 65 in 2010; increase investment return by 0.5% per annum	94	94

The above table illustrates that, even if currently projected mortality improvements continue for the next 50 years, the financial consequences for Defined Benefit pension plans are likely to be manageable, when viewed in comparison with potential changes in the retirement age or variations in investment returns earned by the pension fund.

3. Enhancing Public Understanding of the “Pension Promise”

3.1 Formal Funding Policy

Many plan sponsors do not have a formal funding policy for their Defined Benefit pension plans. *The CIA recommends that the Alberta and British Columbia governments introduce legislation that would require plan sponsors to establish a written funding policy for Defined Benefit pension plans in order to promote clear objectives and transparency. Further, the required annual disclosure by plan administrators to plan members should be expanded to include the key elements of the funding policy, as well as the investment policy and the current funded status of the plan.* These recommendations are intended to encourage better governance and communication.

The funding policy should address both going concern and wind-up bases, giving specific consideration to at least two objectives: benefit security and stability of contributions. It should include a description of the key risks faced by the pension plan and how these

³ [Assumptions](#): Mortality based on Society of Actuaries’ Uninsured Pensioner 1994 Table, with generational mortality improvement using Projection Scale AA. [Source: Transactions of the Society of Actuaries XLVII (1995)] The calculated present values are for an indexed pension payable to a single life, discounted at a real rate of investment return of 3% per annum (3.5% per annum for the final row of the table).

risks will be addressed. The funding policy should normally address items such as actuarial cost methods, the basis to determine best estimate actuarial assumptions, types and magnitude of margins in the actuarial assumptions, target contribution levels (or target benefit levels for plans with fixed contributions), utilization of surplus and contribution holidays and frequency of valuations. The roles of the plan sponsor and the actuary would also be defined in this policy.

For negotiated contribution plans, the funding policy would also need to address benefit policy and other issues related to fixed contributions.

Since the plan sponsor is responsible for establishing the funding policy, including articulation of the level of margins in the actuarial assumptions and funding targets, the actuary would then be responsible for proper measurement and reporting of plan liabilities and costs, including disclosure of pertinent risks, in accordance with the policies adopted by the plan sponsor, regulatory requirements and actuarial standards. The actuary would likely assist in the development of the funding policy and would be guided by this policy when selecting appropriate actuarial assumptions and methods.

The funding policy should be reviewed on a periodic basis to ensure that it remains appropriate to the changing circumstances of the plan. However, there need not be a requirement to file this policy with the regulatory authorities. In this manner, the treatment of the funding policy would be consistent with the treatment currently in place for the investment policy.

3.2 Disclosure of Funding Information to Plan Members

The CIA supports greater disclosure to plan members on the financial position of the plan, funding decisions and contribution holidays, provided that it is meaningful and does not create excessive administrative expense. This information could be provided through the annual pension statement or it could be displayed on the plan sponsor website or through some other vehicle.

We acknowledge that increased transparency in the valuation process would be beneficial to all stakeholders. In particular, the CIA has already implemented greater disclosure in actuarial valuation reports with respect to the rationale for the actuarial assumptions and is investigating increased disclosure for the relative margins for adverse deviations contained within these assumptions. Key aspects of the plan sponsor's funding policy and investment policy would also be disclosed. These increased disclosure requirements would provide the reader with an enhanced understanding of the funded status of a pension plan and the associated risks.

3.3 Education of the Public

Defined Contribution plans, Defined Benefit plans, and other arrangements are all part of a strong and vibrant retirement system. Individuals could conceivably work at different times for employers with any one of the entire array of retirement plans available, or where no plan is offered at all.

All individuals, therefore, should understand and be engaged in the process of saving for retirement from an early age. Education should be available right from secondary school where the seeds of financial literacy can be planted and nurtured. Education could come in many forms – formally, in a classroom setting, or by

government communications using a variety of media, or advertising programs provided by government, employers or financial institutions.

We recommend that governments provide the basics of financial literacy in high school, and encourage employers and financial institutions to become more intimately involved in the education of plan members, potentially involving government incentives and effective safe harbour protection.

4. Conclusion

The CIA supports the extensive work being conducted by the Panel on behalf of the provinces of Alberta and British Columbia. Given the number of discussion/working papers released in the last few years by various governments (provincial and federal) and the Canadian Association of Pension Supervisory Authorities (CAPSA), and the breadth of the research and consultation performed by the Ontario Expert Commission on Pensions, it is clear that the issues related to occupational pension plans (in particular Defined Benefit plans) are top of mind. It is also a welcome sign that Alberta, British Columbia and the other jurisdictions are committed to improving the security of pension plan benefits and ensuring the viability of Defined Benefit pension plans.

The current funding regime applicable to Defined Benefit pension plans can and must be improved. Any revision to the funding rules must reflect the voluntary nature of these plans. We also encourage the governments of Alberta and British Columbia to explore other alternatives aimed at encouraging plan sponsors to both maintain and better fund their Defined Benefit pension plans.

We are confident that it is possible to adopt appropriate legislative changes that implement a framework to alleviate the current problems related to the uncertainty about surplus ownership and utilization and consequently provide a better environment for the long-term viability of Defined Benefit pension plans. We contend that the regulatory system should provide a clear understanding to each stakeholder of their respective entitlements and obligations that is appropriate for their particular circumstances. Actuarial Standards of Practice related to funding and reporting that reflect and support this system can then be developed. This combination will go a long way to encourage higher funding and increase benefit security.

The legislation governing Defined Benefit pension plans is complex, in particular for organizations with plan members in more than one province. With the passage of time, this complexity and the differences among provinces are not lessening; on the contrary, they are only becoming more pronounced. *We encourage all pension regulators and governments in Canada to work together at defining new improved pension standards that are consistently applied across Canada and reflect the need for increased pension coverage, the risks assumed by the various stakeholders and the members' concerns about better benefit security. The CIA is anxious to participate in discussions on these crucial issues.*

Canada's population is aging; the proportion of people covered by occupational pension plans is falling; together these trends are moving Canada towards a potential pension crisis.

The CIA believes that retirement savings ought to be on the national agenda and has encouraged the federal Minister of Finance to initiate a meeting of all provincial and

territorial ministers responsible for regulating pensions⁴ in order to establish a common framework for pension legislation to resolve the coming challenges to the retirement savings system. Pensions are never on the agenda when Finance ministers meet, as only four of them have responsibility for the pension portfolio. We encourage the British Columbia and Alberta governments to strongly support this initiative, promoting it among the other provinces and with the federal government.

⁴ To illustrate the varied ways in which pension regulation is handled in Canada, the following list shows the ministry involved in each jurisdiction:

Alberta–Finance
British Columbia–Finance
Manitoba–Labour & Immigration
New Brunswick–Justice and Consumer Affairs
Newfoundland and Labrador–Government Services and Lands
Nova Scotia–Environment and Labour
Ontario–Finance
Québec–Employment and Social Solidarity
PEI– none
Saskatchewan–Justice
Canada–Finance

CHAPTER 2 – INPUT ON SPECIFIC QUESTIONS FROM THE PANEL

The call for submissions posed a great number of questions, many of which have been addressed in Chapter 1 of this submission. For your convenience, we have included them below along with some commentary and references to other papers that have addressed the issue in question.

Questions re: Occupational Pensions Plans in the Canadian Economy

2(a) *What role, if any, should occupational pension plans play in the Alberta and British Columbia retirement income systems?*

The CIA recently sponsored a study titled, “PLANNING FOR RETIREMENT: ARE CANADIANS SAVING ENOUGH?” by the University of Waterloo’s Department of Statistics and Actuarial Science (the Waterloo Study). Here is a quote from the introduction.

“Our research examined the financial adequacy of retirement preparation for those expected to stop working in 2030.

Our conclusion: two thirds of Canadian households expecting to retire in 2030 are not saving at levels required to meet necessary living expenses. Old Age Security (OAS) and the Canada and Québec Pension Plans (C/QPP) provide a modest base, and by themselves, are not designed to fill the gap. Home ownership will help to narrow the gap, but, by itself, won’t be enough. Participation in a workplace pension plan (RPP), by itself, won’t be enough. And, saving through a Registered Retirement Pension Plan (RRSP) plays an important role, but is unlikely to fill the gap.”⁵

According to the study, **occupational pension plans have a critical role to play as part of an individual’s financial plan**, especially considering that over 30% of Canadians have no financial plan for their retirement.

For more comments on the importance of occupational pension plans to Canadians, please refer to section 1.1 of Chapter 1 of this submission.

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

“**Better workforce management.** Defined Benefit plans help employers retain good employees and they can be a tool to help employers to better manage their workforce (e.g., enhance early retirement.)”⁶

The primary role of an occupational pension plan is to provide retirement income, however, these plans are also excellent tools to attract and retain staff. Defined Benefit plans can include features to improve workforce management, whether that means encouraging early, phased or late retirement. Moreover, the portability requirements of the current legislation help accommodate the transfer of benefits and consequently, worker mobility. Most Multi-Employer Pension Plans facilitate mobility within an industry.

⁵ Planning for Retirement: Are Canadians Saving Enough?, Executive Summary, p. 2.

⁶ CIA Pension Prescription, Saving and improving Defined Benefit pension plans is a better choice for Canadians than allowing their steady erosion, p. 3.

With appropriate changes to pension legislation aimed at better accommodating phased retirement programs, occupational pension plans could play an enhanced role in helping Alberta and British Columbia employers manage an aging workforce in a context of high competition for talent.

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

Clear, simplified and efficient pension standards encourage the maintenance and enhancement of a strong and vibrant retirement system. A pension standards environment that favours maintaining, implementing and improving occupational pension plans in a cost-effective manner would allow Alberta and British Columbia employers to attract, retain and manage the workforce they need, particularly in an economy with changing demographics, while maintaining their costs at an affordable level in an increasingly competitive global economy. Amendments to the existing standards need to be made to attain such a positive environment.

In Chapter 1 of this submission and through our input to the questions, we provide suggestions and recommendations as to amendments to pension legislation aimed at creating a positive context for occupational pension plans.

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

"The Canadian pension system is built on four pillars:

- Universal government plans (Old Age Security, Guaranteed Income Supplement);
- Employment-related government plans (Canada Pension Plan/Québec Pension Plan);
- Other employment-related pensions (e.g., employer or industry-sponsored plans, including occupational Defined Benefit and Defined Contribution plans); and
- Personal savings.

Weakness in any one of these pillars puts pressure on the other three."⁷

Governments influence and encourage the last two pillars through tax and regulation. With occupational pension plans in decline; Canadians not saving enough for their retirement; and universal government plans structured to replace only a portion of pre-retirement income, we believe that governments should work to save and improve the environment for occupational pensions, especially Defined Benefit plans. For a variety of reasons, including, for example, solving the longevity risk problem by promising lifelong benefits, we believe that current Defined Benefit plans need to be saved and new Defined Benefit plans encouraged.

We understand that the Panel's mandate does not encompass the review of universal and employment-related government plans. Should the Panel decide to include potential changes to these plans in its work, the CIA would be pleased to provide input for such a review.

⁷ [CIA Pension Prescription, Saving and improving Defined Benefit pension plans is a better choice for Canadians than allowing their steady erosion, p.3.](#)

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

We recommend that **expanded pension coverage become part of a formal mandate of the Alberta and British Columbia pension regulators** so they can actively participate in promoting occupational pension plans rather than simply performing a regulatory oversight role.

The Waterloo Study shows that Canadians are not saving enough to fund an independent retirement. For this reason and others that are mentioned above, the CIA strongly believes that expanded pension coverage through occupational pension plans must be encouraged. However, individuals' needs and preferences are diverse, as are employers' needs and preferences. Requiring mandatory pension coverage is a massive change requiring agreement among many stakeholders. This concept would involve significant and long debate before deciding on the merits of implementing it and on its details (e.g., what would be the minimum mandatory plan). We rather suggest that governments focus on creating an environment that expands occupational pension plan coverage where both Defined Benefit and Defined Contribution plans can survive and thrive. The initiatives put forward in the CIA's Pension Prescription would help establish that environment and we are convinced that in such a milieu, pension coverage will increase significantly. These initiatives can be implemented in a reasonably short timeframe, therefore rapidly producing a positive impact on pension coverage.

- 2(f) *What role, if any, should employers play in ensuring sufficient pension coverage and income in retirement?*

Many studies (including the Waterloo Study) lead us to believe that, when they are left to their own devices, **Canadian individuals lack the discipline and/or resources to appropriately save and plan for retirement.** Employers have an interest in facilitating transition from work to retirement in a manner that meets their workforce management needs. For example, employees who happen to be older and less productive, who have not planned correctly for retirement and/or cannot afford to retire may have a negative impact on the staff's morale and overall productivity of the organization. For these reasons, employers should be encouraged to provide pension coverage. Our sense is that a significant step in providing such encouragement would be achieved if governments worked together to improve the Defined Benefit pension plan regulatory environment and produce a legislated solution to the surplus ownership issue.

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

The Waterloo Study tells us that almost a third of Canadians have no savings, no occupational pension plan and do not own a house. Two thirds of Canadians over 40 are not saving enough for an independent retirement. Other surveys indicate that a majority of Canadians are unsure about what their retirement income will be when they retire or have ever tried to calculate how much they will need to retire comfortably. **A large group of retirees with inadequate incomes will likely become a social, and hence, government issue;** thus it makes sense for **governments to foster the growth of occupational pension plans and individual savings now, rather than wait for the crisis in 20 years.**

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

The CIA believes that **this is a joint responsibility**. Individuals, whether in an occupational pension plan or not, must be engaged in the process of saving for retirement from early ages. Governments can implement financial literacy programs in the school system, while employers can take on the continuing education process in the workplace. In addition, the CIA recommends that plan sponsors improve the transparency of Defined Benefit plan funding through improved communications to plan members.

- “3. Introduce legislation that would require plan sponsors to establish a written funding policy for Defined Benefit plans in order to promote clear objectives and transparency.
4. Expand the required annual disclosure by plan administrators to plan members, to include the key elements of the funding policy, investment policy and current funded status.”⁸

Several surveys indicate that, by and large, members of Defined Contribution plans tend not to fully appreciate the relationship between the value of the assets accumulating in their savings account and the level of retirement income that may be produced from that account. As a result, many plan members confuse the retirement income objective of a pension plan with other asset accumulation goals, such as estate planning. Educating members of occupational pension plans (especially Defined Contribution plan members) about saving for retirement is not necessarily a simple task when all relevant elements are considered. These include the investment horizon, expected date of retirement, structure of lifetime retirement income, protection of dependents, inflation protection and the tax implications of various savings vehicles.

To improve the information provided to plan members in Defined Contribution arrangements, current Capital Accumulation Plan Guidelines could be expanded to provide additional direction for disclosure and decision-making tools where the primary purpose of the plan is to provide retirement income.

Please refer to section 3.3 of Chapter 1 for recommendations to improve education of the public.

Questions re: Pensions Standards Legislation – Past, Present and Future

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

In many organizations, the pension plan model has been shifting over the past several years, from one in which the plan sponsor assumes all risk (the traditional Defined Benefit plan) to one in which plan members assume all risk (the traditional Defined Contribution pension plan). This transfer of risk has been from one end of the spectrum to the other. However, we believe there are many plan sponsors who would be willing to share pension risk with plan members, if the opportunity were available.

“One-size-fits-all” legislation is too rigid to accommodate a number of risk-sharing plan designs. We recommend that the British Columbia and Alberta governments introduce standards that would accommodate the variety of plan designs that are currently in place, and encourage new designs. For example, cash balance plans

⁸ [CIA Pension Prescription, Improve the transparency of plan funding, p.7.](#)

should be allowed and it should be possible for a pension plan to express the benefit accruals in the form of a number of "shares", which will increase in value during the members' working careers through an excess interest approach.

We would note, however, that often in the past, it has been the *Income Tax Act* or Canada Revenue Agency's interpretation of the *Income Tax Act* that has stifled more innovative plan designs. Any initiative to create flexibility in plan design would have to include the federal Department of Finance and, possibly the Canada Revenue Agency.

We recommend that the governments of British Columbia and Alberta create a task force consisting of representatives from the pension standards branches of both provinces, representatives from the Department of Finance and representatives from the pension industry (including CIA representatives) to review provisions of the *Income Tax Act* and pension standards legislation that inhibit the development of innovative plan design. The mandate of the task force could include:

- a review of plan designs that consultants within Canada have contemplated and would have some attraction for plan sponsors, but which have not been developed because of legislative constraints;
- a review of pension standards legislation in other countries to determine how their legislations might accommodate certain plan designs that are not permitted within Canada.

3(b) What should be the goals of the legislation?

The primary goals of pension legislation should be:

- 1. Protection of benefits for plan members, through reasonable and efficient benefit standards and advance funding at arms length from sponsor;**
- 2. Provide increased certainty to plan sponsors to encourage the expansion of occupational pension coverage to supplement the minimum income level provided through government programs; and**
- 3. Facilitate clarification and understanding of the pension promise.**

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

Pension legislation should be primarily aimed at ensuring that as many individuals as possible will have enough income to live independently in retirement. It should not be used as an instrument of social policy that in any way detracts from that aim, but only when it aligns with that aim. For instance, legislation that makes it easier for plans to be designed around phased retirement may encourage many older employees to remain in the workforce longer. This will reduce pressures on the economy that might result from a too rapidly shrinking workforce, but at the same time will shorten the amount of time the individual will be fully dependent on retirement income.

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

The CIA believes that **governments need to amend their legislation to encourage the safeguarding of occupational pension plans and encourage employers to**

implement more plans. The recommendations mentioned in Chapter 1 of this submission are mainly focused on this important objective.

We believe that pensions need to be put on the national agenda, and soon.

We often see ministers with specific portfolios from across the country meeting to discuss issues of common interest. It would be helpful if pensions could be put on the agenda for the next Finance Ministers' Meeting, however, only a handful of ministers have responsibility for the pension file in their jurisdictions. In Saskatchewan, pensions fall under the Justice ministry. In New Brunswick, it resides in Justice and Consumer Affairs. In Québec, pensions fall within Employment and Social Solidarity. This combination of ministers never meets. Thus pension issues never get a national airing.

We encourage the governments and Finance ministries of Alberta and British Columbia to take the lead with other pension regulators and governments in Canada to come together to define pension standards that are consistently applied across the country. These need to reflect the need for increased pension coverage, the risks assumed by the various stakeholders and the members' concerns about better benefit security. Building on the high degree of cooperation in CAPSA would be helpful in this regard.

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

Ontario has just begun a review of its pension legislation, and Nova Scotia is about ready to start. The Finance Committee of the federal government included some changes to pension regulation as one of its recommendations to the Finance Minister in the most recent budget submission. Other provinces will likely soon follow.

A meeting of the ministers responsible for pension regulation in Canada would be very useful in determining a list of 'best of class' pension regulation practice in Canada.

Some of the recommendations we made in Chapter 1 have been adopted in other Canadian jurisdictions (e.g., Target Solvency Margins, allowing letters of credit for solvency amortization payments and annual actuarial valuation requirement). Other approaches that we would recommend adopting include:

1. Elimination of partial plan terminations (Québec): This would not only eliminate the potential surplus distribution issue on partial termination but would also remove the administrative and cost burdens related to plan terminations;
2. Phased retirement (Federal): Allow payment of accrued pension and further accrual of pensions under phased retirement agreements;
3. Simplified Defined Contribution pension plans (Québec).

A meeting of the ministers responsible for pension regulation in Canada would be very useful in determining a list of 'best in class' pension regulation practice in Canada.

Questions re: Broad Pension Policy Issues

4(a) How important is harmonization of pension standards between Alberta and British Columbia?

We believe that **harmonization of pension standards between Alberta and British Columbia is very important.** Such harmonization will reduce the confusion that can

exist due to the various pension standards from province to province, and also administrative costs. This process is a good model for other provincial governments and the federal government to follow. With pension regulation reviews happening this year in Ontario, Alberta, British Columbia and Nova Scotia, we encourage these governments and regulators to work together to increase stability by harmonizing their pension regulations. This core group could encourage many other provinces and the federal government to join the process.

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

"9. Amend legislation where required so that pension matters fall within the authority of the Ministers of Finance throughout the country to allow for pensions to be included on the national agenda and to promote consistency of pension legislation among jurisdictions." ⁹

This suggestion will be complex for governments to implement, however, a meeting of all federal and provincial ministers responsible for pension regulation is a necessary first step. The **CIA would be excited to work with governments to organize a Pension Summit to explore ways for regulatory harmonization to be established.**

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

There needs to be a **mixture of rules-based and principles-based regulation**. For example, for investments, regulation should be principles-based. For items like vesting and locking-in, it is difficult to have something other than rules-based regulation.

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

The CIA agrees that pension plans should be operated using good governance principles, and to the extent legislation is required to make it happen, we would encourage it. Plan sponsors and administrators have spent considerable effort to review and comply voluntarily with guidelines. Such guidelines **should be principles based and provide sufficient flexibility to develop governance models that reflect the unique circumstances and needs of each plan.**

Uniform and relevant governance guidelines (periodically updated as appropriate) that accommodate the various sizes, designs and circumstances of pension plans, constitute the preferred regime. Unless it is demonstrated that this regime does not work, **we would not encourage making the leap from guidelines to statutory provisions.**

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

The **cost of regulating pension plans should be kept at a low level.** Otherwise, this cost, if recovered through fees charged to plans under supervision, would become another obstacle to achieving increased pension coverage. Accordingly, pension regulators should focus on high risk situations and avoid ineffective initiatives (e.g.,

⁹ [CIA Pension Prescription, Introduce innovative ways to meet funding requirements, p. 5.](#)

collection of unnecessary information). We encourage clear disclosure and accountability by regulatory authorities for fees charged to pension plans.

Questions re: Specific Elements of the Standards

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

Actuarial valuations on a solvency basis show how secure the promised benefits are. Actuarial valuations on a going concern basis are more concerned with calculating sufficient yet stable contribution levels. **Actuarial valuation reports should highlight both of these two key objectives – the security of benefits in the event the Defined Benefit plan is wound up, and the appropriate level and stability of contributions if the plan is continued for the long term.** As the main concern of governments is expected to be benefit security, we believe that minimum funding rules should focus on the solvency results.

However, below we outline special considerations for Multi-Employer Pension Plans (MEPPs) and Negotiated Cost Defined Benefit (NCDB) pension plans. Current pension standards legislation presumes that on plan wind-up all annuities will be purchased at the same time. However, the group annuity market in Canada is limited in size and in the types of product offered. As a way of dealing with the absence of an annuity market for certain types of pension liabilities, we recommend that British Columbia and Alberta allow the pension plan to settle a larger proportion of its obligations through the payment of lump sum commuted values than is allowed under current legislation.

Special Considerations for MEPPs and NCDB Plans

For MEPPs in which the employer contributions are not negotiated, and the pension “deal” is for a Defined Benefit in which the individual contributing employers are responsible for the risk of unfunded liabilities, solvency deficiencies and increases in the normal cost, then the same solvency tests should apply to the MEPPs that apply to single employer pension plans.

For MEPPs in which the employer contributions are negotiated and the pension deal is for the negotiated contributions combined with a target (but not promised) benefit established by a board of trustees, solvency funding may not always be appropriate. These plans are referred to as NCDB pension plans, and they have no source of contributions to fund solvency deficiencies emerging as a result of short-term fluctuations in the markets. This structure applies to most MEPPs in the pension environment. A variation of NCDB plans is one in which the benefit is defined by the plan text (and fixed), the contributions are defined by the plan text (and fixed), and the trust agreement or other plan document prescribes a process for sharing the risk of unfunded liabilities, solvency deficiencies and increases in the normal cost.

The structure of a NCDB plan also applies to some single employer pension plans, in which the employer has negotiated with one of its unions a pension plan in which the contributions are negotiated and fixed during the term of the agreement. The pension plan is also administered through a board of trustees, like a MEPP. In our following discussion of NCDB plans, we are including single employer pension plans that are NCDB plans along with any MEPP that is a NCDB plan.

Funding issues for NCDB plans can be complex. Under these plans, the fixed component is the contributions from the contributing employers. These contributions cannot be changed until the next contract with each employer is

negotiated, and often these contracts are negotiated at different times for different employers. The CIA acknowledges that NCDB plans have a high degree of risk. These risks arise from the following characteristics, amongst others:

- A diffuse decision-making process, because of the consultative nature of the board of trustees. In some cases, decisions are based on compromise approaches;
- The withdrawal of one or two key employers can put the plan at risk;
- Some NCDB plans are in declining industries and have a shrinking contribution base to support financial shortfalls;
- Some NCDB plans have an aging population which, in turn, places upward pressure on the current service cost;
- Many NCDB plans are unable to meet the cost of deficiencies arising from short-term fluctuations in the market or deficiencies arising from long-term shifts such as improvements in mortality.

The structure of NCDB MEPPs (i.e., multiple employers contributing to a single trust) tends to mitigate the chances of a NCDB MEPP being wound up. Occasionally, though, this does happen. Even when a NCDB plan is not fully wound up, contributing employers can withdraw from a plan at any time. Withdrawal from a NCDB MEPP can occur for a variety of reasons (insolvency of the contributing employer, plant closure, decertification, etc.). The consequences to the plan of the employer withdrawal are similar to the consequences on full plan wind-up with respect to the benefits of the affected members. This raises the question of how to protect the benefits of plan members whose employers contribute to a NCDB MEPP, given these risks and the potential for a shortfall in benefits on employer withdrawal or the wind-up of the NCDB MEPP.

For NCDB plans in which the employer contributions are negotiated through collective agreements, solvency funding creates certain problems in the current economic environment:

- It creates intergenerational transfers within the pension plan;
- It limits, or prevents, legitimate improvements to pension benefits even though there is a going concern surplus in the plan;
- It forces the plan to consider benefit reductions even if the plan is fully funded on a going concern basis using reasonably conservative actuarial assumptions.

Thus, when economic problems emerge, and the NCDB plan is unable to meet minimum funding standards, it is the target benefit that must give way, since the contributions cannot be adjusted upwards.

NCDB plans are rather like Defined Contribution pension plans where a target benefit is stated. These target benefits can be increased (as they have in the past), and they can be decreased (as some have been forced to more recently).

Since NCDB plans are delivering target benefits, the issues from a regulatory perspective may be the following:

- How can the NCDB plan provide some level of certainty that the target benefit will be met?
- What sort of disclosure should be provided to plan members?

The CIA recommends that the Panel explore developing different funding standards for NCDB plans. These funding regulations could eliminate solvency funding for NCDB plans, and focus on the going concern valuation. The regulations should include constraints on the amortization period for going concern unfunded liabilities, the selection of actuarial assumptions and/or the investments. When developing different funding standards for NCDB plans, the CIA recommends that the Panel explore the impact that any proposed standard would have on a sample of the NCDB plan's population, to ensure that the proposed funding standards are reasonable, and not overly onerous or lax.

Secondly, the CIA recommends that benefit improvements for NCDB plans be conditional upon the plan attaining a certain funding threshold. This threshold could be based on different formulas, such as assets exceeding a certain percentage of the accrued liabilities on the going concern basis, or tests against the liabilities determined using a risk free rate of return.

5(b) Should the minimum funding rules take into account the financial health of the employer sponsoring a Defined Benefit plan, and if so, how?

The ability of a pension plan to become well funded depends on a number of factors, including the health of a plan sponsor. However, it can be difficult to assess the financial strength of a plan sponsor, particularly if the plan sponsor is a private company, a wholly owned subsidiary of a company, or if the plan is a Multi-Employer Pension Plan.

It would be very difficult for the minimum funding rules to take into account the financial health of the employer sponsoring a Defined Benefit plan. However, the British Columbia and Alberta regulators might, in their risk assessment models, incorporate "financial health ratings" by industry or by individual plan sponsors that prompt closer scrutiny of these pension plans.

If the Alberta, British Columbia and federal governments **implement Target Solvency Margins and Pension Security Trusts, this would reduce the number of situations where the financial health of the plan sponsor becomes a concern.**

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

The risk profile of the pension plan is easier to assess than the financial health of the employer, and we believe it would be appropriate to build the risk profile into the minimum funding rules. One method of recognizing the risk profile of the pension plan would be for all plans to maintain a portion of the surplus as a Target Solvency Margin. **The amount of the Target Solvency Margin would vary according to the potential volatility of a plan's funded position,** thereby ensuring more secure funding based on the level of risk of the plan. Please refer to section 2.1 of Chapter 1 of this submission for further details on the concept of a Target Solvency Margin.

5(d) Should each Defined Benefit plan be required to have a funding policy? If so, should it be a regulatory filing requirement?

Answers to these questions are found in section 3.1 of Chapter 1 of this submission.

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

"One-size-fits-all" legislation is too rigid in the current economic and pension environment, and to accommodate a number of risk-sharing plan designs. We recommend that the British Columbia and Alberta governments **introduce**

standards that would accommodate the variety of plan designs that are currently in place, and encourage new designs. For more details, please refer to our response to question 3(a).

Current pension models that would attract different rules include single employer Defined Benefit plans, single employer Defined Contribution plans, flexible plans, hybrid plans and NCDB plans. Legislation should accommodate the differences in these plans, in terms of benefit standards, funding standards and disclosure standards.

- 5(f) *Are there compromise solutions to the conflict between risk-reward asymmetry and benefit security in Defined Benefit plans?*

In section 2 of Chapter 1 of this submission, we discuss **the concepts of a Pension Security Trust and Target Solvency Margins. We believe that the adoption of these concepts, combined with an increase to the maximum surplus level and the use of letters of credit to guarantee solvency deficiency amortization payments, would help significantly to address the conflict between risk-reward asymmetry and benefit security in Defined Benefit plans.**

However, we would emphasize that these measures need to be adopted as a package. If only some of the measures are adopted, the solution to this conflict will not be adequately addressed.

- 5(g) *How can the conflict between short-term benefit security and long-term contribution predictability for Defined Benefit plans be best addressed?*

Please refer to our response to question 5(a) and also sections 1.2 and 2 of Chapter 1.

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

The CIA believes **the current investment standards are adequate.** We recognize there is a relationship between the ability of a plan sponsor to ensure the pension plan is consistently fully-funded and the investment policy. To measure this relationship, the amount of the Target Solvency Margin would vary according to the potential volatility of a plan's funded position, thereby ensuring more secure funding based on the level of risk of the plan.

Furthermore, in a risk assessment regulatory system, regulators would be able to take into consideration the Target Solvency Margin and the asset mix to determine the risk profile of the pension plan.

- 5(i) *What specific standards could be classed as "irritants," and how should they be changed?*

The **solvency funding standards have created significant challenges for NCDB plans.** Many of these plans have a surplus on a going concern basis and a deficit on a solvency basis. Moreover, it is difficult to argue that solvency funding should apply to these plans, since the employer's obligation is the negotiated contribution. The stated benefit is only a target, albeit one where a decision to reduce it would not be made lightly. As mentioned in our response to question 5(a), we believe that the regulators should consider the employers' obligation under these plans, and develop different funding requirements accordingly. Moreover, the following standards are seen as "irritants" by many stakeholders:

- **Under British Columbia legislation, the requirement that plan wind-up expenses be paid by the plan sponsor; and**
- **For Defined Benefit plans using a pension formula based on a C/QPP benefit offset, restrictions based on the C/QPP benefit payable to the member in lieu of the maximum benefit payable by the C/QPP to an individual aged 65.**

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

The CIA supports greater disclosure of meaningful financial information.

For Defined Benefit plans, information should be provided to members on the financial position of the plan, funding decisions, the funding risks inherent in the asset mix and contribution holidays, provided that it is meaningful and does not create excessive administrative expenses. This information could be provided through the annual pension statement or it could be displayed on the plan sponsor website or through some other vehicle.

For Defined Contribution plans, information should be provided to members on the type and amount of expenses that members are paying through reduced returns or flat assessments, the implications of the different asset mixes the members have access to, the expected accrued pension in current dollars and the expected pension at retirement in current dollars, assuming contributions continue at the same level and the fund the member has chosen achieves investment returns that are consistent with the asset mix for that fund. Any requirement to provide these additional information items should involve effective safe harbour protection for plan sponsors and administrators, and should not create excessive administrative expenses.

The CIA recommends that disclosure be improved for NCDB plans. This disclosure could include some indication of the risks assumed by the plan members, including the risk of target benefit reduction (see question 5(a)), and current information on how the risks are being addressed by the trustees (e.g., funded status, funding approach, etc.).

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

As mentioned above, **minimum standards that require providing pension or future investment return information to Defined Contribution plan members should involve safe harbour protection for plan sponsors and administrators**, considering the litigation risk involved with providing such information.

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

The CIA believes that the **pension standards legislation should be reviewed in the context of recent *Income Tax Act* amendments that accommodate phased retirement agreements and permit plans to give members the option to receive partial pension payments while continuing to work and accrue further pension benefits.** Pension standards legislation should accommodate phased retirement agreements but without mandating phased retirement options for plan members.

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

The CIA would **encourage innovation in plan design and financing arrangements that promote the growth of occupational pension plans.** For example, cash balance plans, which are used extensively in the United States, are effectively prohibited in Canada under the existing legislation. Other designs that may offer additional flexibility to plan members and assist employers in attracting and retaining employees would be welcome.

We would note that, often in the past, it has been the *Income Tax Act* or Canada Revenue Agency's interpretation of the *Income Tax Act* that has stifled more innovative plan designs. Any initiative to create flexibility in plan design would have to include the federal Department of Finance and, possibly, Canada Revenue Agency.

5(n) *Are there some pension standards that should be abandoned or changed significantly, and why? What new pension standards, if any, are required in the next generation of legislation?*

The two key issues that have created significant burdens for sponsors of Defined Benefit plans have been **the lack of uniformity amongst the minimum standards of different jurisdictions, and the trust environment within which pension plans operate.**

The CIA recognizes that uniformity of pension legislation across all Canadian jurisdictions is a difficult, if not impossible, objective to achieve. Essentially, the constitution would have to be changed. Having said that, the CIA believes it is important to achieve as much uniformity as possible. We strongly encourage British Columbia and Alberta to take the lead on this issue, and align both the *British Columbia Pension Benefits Standards Act* and the *Alberta Employment Pension Plans Act* so that their minimum standards are as uniform as possible.

The second issue, the trust environment for pension plans has created significant challenges for the administration of Defined Benefit pension plans, and we comment on this issue extensively in our submission to the Ontario Expert Commission on Pensions. The CIA recommends that British Columbia and Alberta clarify that documents establishing pension plan funding vehicles are documents of the plan, subject only to the provisions of the *British Columbia Pension Benefits Standards Act* and the *Alberta Employment Pension Plans Act*, as the case may be, and their regulations; and state explicitly that to the extent of any inconsistency with the common law, the provisions of the *British Columbia Pension Benefits Standards Act* and the *Alberta Employment Pension Plans Act*, as the case may be, and their regulations are paramount and supersede the common law.

These changes would provide significant support to Defined Benefit pension plans, and would ease the regulatory burden of partial terminations, mergers, splits and asset transfers.

Questions re: Related Legal Frameworks

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

Federal-provincial and intra-provincial differences make the system unnecessarily complicated. Here's a concrete example. Recently, when working on an educational pamphlet for plan members from across the country, a plan sponsor

was surprised when it was found that the definition of the term, "spouse" ran to more than eight pages. This was precisely because the legal definition of the term varies from province to province.

Once again, harmonization of legislation federally and provincially would be helpful.

Finally, throughout this submission, we have highlighted changes to the provincial and income tax legislation that are aimed at creating a more positive environment for the maintenance, implementation and improvement of occupational pension plans.

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

See 6(a)

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

See 6(a)

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

This is an area for lawyers, however, please refer to our response to question 5(n) regarding trust and common law issues.

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

A critical issue that must be resolved is that of **surplus ownership and utilization**. Comments on this issue and suggested legislative changes are provided in section 1.2 of Chapter 1 of this submission.

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

Any solution to deal with legacy issues should balance:

- **the need to recognize that existing contracts or agreements between the plan sponsor and plan members will need to be respected; and**
- **the urgent necessity to create a positive context for the continuation and creation of occupational pension plans.**