NOVA SCOTIA

Pension Review Panel: Position Paper

For Discussion

October 17, 2008

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Dear Stakeholder:

The Nova Scotia government announced in November 2007 that it would be creating an advisory panel to review the current pension legislative framework. As a result, in February 2008 an independent Pension Review Panel was appointed including myself, Bill Black, former President and Chief Executive Officer of Maritime Life as Chair of the Panel, Ron Pink, an experienced labour lawyer, and Dick Crawford, from Mahone Bay, a former president of the Canadian Institute of Actuaries.

On May 28, 2008, we released a Discussion Paper for public review and comment. The paper posed questions focussing on areas where we wanted input. In response, we received 51 written submissions from unions, actuaries, employers, employees and various groups and associations. In addition to providing written submissions, some of the submitters were invited to meet with us to discuss the concepts and views noted in their submissions. Both the written submissions and the subsequent discussions have been of high quality and we are indebted to those who have contributed.

After reviewing all of the submissions, both written and oral, we have decided to release this second document to the public. The purpose of this paper is to provide our tentative answers to the questions that we posed in our Discussion Paper, and to elicit further comments from interested stakeholders.

As with the Discussion Paper, this document, as well as any feedback on its contents, will be posted to our website at:
http://www.gov.ns.ca/lwd/pensionreview/.

Please send any written comments you may have by **November 14, 2008** to:

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Thank you for taking the time to review this material and provide input.

Sincerely,

Bill Black, Chair
Pension Review Panel

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1.0 Background

1.1 Mandate and Composition

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

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

(2) To enhance the affordability and availability of defined contribution and defined benefit pension plans for employers and employees;

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

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

(5) To eliminate unnecessary rules and regulations.

There has not been a comprehensive review of the *Pensions Benefits Act* since 1998, with resultant legislative changes made effective January 1, 2003. The current review includes consultation with the pension management industry, actuaries, unions and employers. The Panel has been tasked with making recommendations for potential changes to Nova Scotia's pension legislation.

The approach to conducting this review has been through a Discussion Paper, outlining the proposed areas of change and seeking input on the issues both through meetings with employers and employees, as well as with pension experts, and through written comments.

The discussion paper was developed and edited first by the Panel to ensure it addressed the key issues, and then released to stakeholders on May 28, 2008, who were given until July 4th, 2008 to make comments. Some of the stakeholders were invited to meetings with the Panel in July and August, 2008. The purpose of these meetings was for the Panel to further discuss and understand the views expressed. The Panel has reviewed the written and oral submissions and will file a final report to Government in November or December of 2008.

1.2 Historical Overview

The rules and regulations surrounding Pensions have accumulated over the years, and this gradual accumulation has created today's pension environment in Nova Scotia, with its attendant challenges:

Firstly, the underlying basis was built around defined benefit plans. But many plans today are of a different type—defined contribution or target benefit for example. The present rules often cause unnecessary complications for those plans.

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

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

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

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

1.3 Employee and Employer Perspectives

The Panel commissioned independent research with respect to employer and employee attitudes towards pensions[1]. Younger employees show little understanding of or interest in pension plan arrangements. This occurs in part because many do not expect to retire with their current employer. The level of interest grows with age and becomes quite strong as employees near retirement. Only at that stage do employees seriously engage with the question of retirement income adequacy. Yet most employees of all ages agree that planning for retirement is a personal responsibility.

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

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

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

2.0 Review of Public Consultations

The Panel received 51 written submissions[2] in response to the Discussion Paper. In an effort to further understand the issues and views raised in some of the written submissions, the Panel invited some of the submitters to meetings, which were held in July and August, 2008. The written submissions and meetings were invaluable in helping the Panel come to its tentative conclusions.

2.1 Panel's Perspective

The following is a general overview of the Panel's perspectives. It was thought that including this overview may be helpful to understanding the detailed answers to the Discussion Paper questions that will be discussed in the next section of this paper.

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

This requires complete transparency of information, so that employees (and their representative) can be fully informed on issues affecting their plan such as funding status, proposed benefit changes (when the associated amendments are filed with the Superintendent), and regulatory issues. The Panel also believes that pension plans will work much better when there is active employee involvement through joint trusteeship or other means, such as active employee Advisory Committees.

Employers have a choice about whether to have a plan at all, subject of course to collective bargaining. It is widely accepted that pension costs are a tradeoff against current wages. Different groups will want different tradeoffs. The Panel does not believe that benefit tradeoffs should be made by government.

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

Finally, while there are developments to be hoped for involving other jurisdictions (raising the tax limit, harmonization with other regulatory jurisdictions), we must

[2] NS Pension Review: http://www.gov.ns.ca/lwd/pensionreview/

have a legislative framework that works well with the existing environment while remaining open to potential future developments.

2.2 Goals of Pension Legislation and Regulation

While pension rules can be very complex, the goals of pension legislation should be clear. The Panel's starting point in reviewing the legislation and regulations and understanding the issues has been to create a list of overarching goals that should apply. Once the goals are established, the complex issues can be addressed.

In the Discussion Paper, five goals were enumerated and stakeholders were asked if any other goals should be added to list. As a result of stakeholder input, the goals have been revised as follows:

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

In the same way that the Panel finds it helpful to have a list of goals, it is also helpful to have a list of what the legislation and regulation should avoid:

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

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

3.0 Panel's Answers to Key Questions

The Panel's Discussion Paper posed questions focusing on the areas where the Panel wanted input. The Panel's review and discussions of the submissions have led to the following tentative answers.

It should be noted that while some of the questions are identical to those posed in the Discussion Paper; other questions have been revised or omitted from this discussion based on the Panel's further understanding of the issues. It should also be noted that there are a number of issues not covered in the Discussion Paper that will be addressed at the end of this section.

3.1 Types of Pension Plans

QUESTION*:*
What kind of arrangements do we want the legislation to enable?

ANSWER:

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

Benefit Design:

- Defined Benefit (DB) plans
- Defined Contribution (DC) plans
- Adjustable Contribution/ Benefit (ACB) plans
- Combinations of the above benefit designs
- Accommodation of new designs by subsequent regulation

Funding Sources:

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

3.1.1 Adjustable Contribution / Benefit Plans

While DB and DC pension plans are common pension plan designs, Adjustable Contribution / Benefit (ACB) plans may not be familiar to some. There are a number of forms of ACB plans in Nova Scotia and other jurisdictions. The format generally includes defined contribution funding with a particular level of benefit being targeted. Both contributions and benefit levels are potentially changeable as circumstances warrant. The plans are effectively jointly funded, either explicitly or because employees have given up some of their earnings for the pension plan. A very attractive feature of these plans is the joint trusteeship model between employees and employers(s). Therefore, it is the Panel's view that:

(a) ACB plans should be available for single employer or multiple-employer groups. (Specified Multi-Employer Pension Plans are an example of this format.)

(b) Joint trusteeship of the plan is to be mandatory.

(c) There is no concept of surplus for these plans. All employer contributions are fully committed to the plan.

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

QUESTION*:*
Should the current trend towards fewer DB plans be accepted, or should regulators permit DB plans that may be more attractive to employers?

ANSWER:

The government should encourage more DB plans through more flexible legislation and regulation and through promotional activities. Promotion should be a function within the Department of Labour and Workforce Development, separate from the office of the Superintendent of Pensions.

QUESTION:
In the case of DC plans, to what extent should an employee's right to make investment choices be limited, and by whom?

ANSWER:

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

a) There should be a default investment option for those employees who do not select their investment option;
b) The options offered to employees by the sponsor should be chosen prudently;
c) There should be good communication to the members about the investment choices available;
d) The sponsor should document the rationale for the investment array and file it with the Superintendent.

Legislation should permit default enrolment and default investment mix selection but should not attempt to specify what is an acceptable investment mix.

QUESTION:
Should DC members have the ability to use different disbursement options, such as LIF type payments, rather than be required to convert funds on their retirement date?

ANSWER:

In the case of DC plans, once an employee reaches age 60, they should be completely free to choose what they want to do with their retirement funds. The legislation should not restrict what individuals over age 60 can do with their retirement funds. While plans can create more restrictions if they choose, restrictions should not be imposed by regulation.

3.2 Province Wide Plan

QUESTION:
Is the idea of a province wide pension plan for some public or private employers a good idea?

ANSWER:

The Committee recognizes the growing concerns by Plan sponsors regarding the complexity, risk, and legal obligations which confront Plan sponsors. In order to minimize these concerns, the Committee is recommending that the Province of Nova Scotia support the establishment of plans available to all employers in the province, administered by an independent agency:

(a) The Plan the Committee recommends would provide an Adjustable Contribution / Benefit and/or Defined Contribution plan options for employers of any size in the Province of Nova Scotia. It would be open to any employers who want to participate.

(b) A particular benefit and funding version could be constructed for municipalities in consultation with them. It would not be mandatory.

(c) Consideration should be given to requiring all employers above a certain size who do not already have a plan to participate in the province wide plan unless they opt out.

The provincial agency would be responsible for the pooling of administration and investments, but would not be responsible for the funding risks, nor for any costs to administration or investment management.

3.3 Funding

QUESTIONS:
Are current rules for measuring and remediation of going concern and solvency deficits appropriate?

Should there be exceptions to the funding rules for universities, multi-employer pension plans and municipalities, or anybody else?

Should going concern funding still be a regulatory requirement?

Should promises as to future benefit accrual be restricted to the level that can be funded by contributions?

Should there be a requirement for full funding at wind-up?

ANSWER:

Much of the debate and resulting complexity in pension regulation surrounds funding.

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

We do not agree with the implied notion that all municipalities and universities are more credit-worthy than all private organizations—it is not difficult to cite counter-examples. And we do not believe that the Superintendent of Pensions should be in the business of evaluating creditworthiness.

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

We agree that the solvency test is inappropriate for all plans. But we favor a different remedy. We propose that valuations be made on an Accrued Benefit basis (see Appendix B) which includes consideration of ALL promises, but which is done using actuarial assumptions closer to those for going concern valuations. Both surpluses and deficits should be straight line amortized over eight years.

In summary, the Panel has come up with the following baseline for the issue of minimum funding:

(a) Tests of funding adequacy must value for **all** promises made; and

(b) The present solvency funding and going concern measurements should not be required for regulatory purposes. Instead, the Panel prefers an accrued benefit measurement.

(c) On wind-up, plans have to fully fund the benefits promised.

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

(e) No benefit improvements should be allowed if the plan is in deficit.

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

3.3.1 Amortization

Currently, the amortization period to achieve full funding of deficits is 5 years. However, three exceptions to this 5 year rule currently apply. Universities have been given a temporary extension of their amortization period of 15 years. Multi-employer pension plans have been provided with a 3 year exemption from solvency funding, and finally, municipalities were provided an exemption from the requirement to fully fund a deficit over 5 years. Rather, they are required to fund only to 85% solvency over the five year period.

The rules ensuring minimum funding should apply equally to all plans. Therefore, the Panel recommends that all plans subject to the PBA should have a straight line amortization period for deficits over a maximum of 8 years, which, once the legislative changes are made, would apply to sponsors from the next valuation date onwards.

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

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

(b) Actuarial valuations are to be done on a fixed three year schedule. Annual tests will be required for plans whose deficits are greater than the 5% collar. These tests would update the most recent valuation by calculating:

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

    If the deficit is greater than the 5% collar, then the **full** deficit, not just the portion over the collar, must be amortized.

(c) In the case of ACBs (including SMEPPs), if a plan is below the 5% collar, then they must adjust benefits or contributions to a level that will bring them to 100% funded within 8 years.

(d) If a subsequent valuation shows an increase in deficit, then the previous deficit amortization schedule continues and a new amortization schedule for the new deficit will begin. This will tend to front end the amortization. For example, if a plan is 93% funded in 2008, it will be given up to 8 years (to 2016) to amortize that deficit. If a new valuation in 2009 shows that the plan is now only 88% funded, while the original deficit will still have 7 years left (until 2016) to amortize, the incremental deficit will have a maximum of 8 years.

(e) If a deficit requires an increase in contributions, including requiring an increase in employee contribution, sponsors are not required to go back to the original valuation date. They have up to a year from the valuation date to begin making the increased contributions. However, their end date will be the same, eight years from the valuation date. In other words, if the sponsor begins amortizing the deficit one year after the valuation date, the annual payment will be $1/7^{th}$ of the total deficit.

(f) Appendix B provides a detailed description of this mechanism.

3.3.2 Surplus

QUESTIONS:
Should regulators speak to the question of the ownership of plan surpluses? If so, what should it say?

ANSWER:

It was noted in the Discussion Paper and in many of the submissions that were received that an “asymmetry” exists between employers/sponsors and employees in DB pension plans. While the Panel agrees that an “asymmetry” exists, it does not agree that this means that employers/sponsors carry all the risks, while employees carry none. Unless an employer can demonstrate that they will exist forever, employees are at risk that the employer may cease to exist. Employees are also at risk of being asked to make additional contributions if the plan requires increased funding.

In the case of surplus, many of the submissions indicated that plans are often minimally funded due to the uncertainty of surplus use and ownership. The

Panel has recognized this and considered how the impact of volatility of the funding position could be mitigated:

(a) Like deficits, surplus should be amortized over a minimum of 8 years. This would allow plans to benefit from the surplus slowly, which would provide a cushion to mitigate any sudden changes in funding status. Amortization would be through prospective reductions in minimum funding requirements.

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

(c) Cash may be withdrawn only after plan wind up when all obligations have been fully met. If so, the sharing of cash withdrawals must result in the employer(s) having paid at least 50% of the net contributions over the previous 10 years.

(d) With respect to who is entitled to the benefits of any surplus, the plan sponsor can make the allocation, subject to plan rules, and the impact of collective bargaining. But the result of any choice must be that the sponsoring employer(s) will receive no more than 50% of the surplus resulting from the final wind up.

(e) In the case of DB and ACBs (including SMEPPs), those plans that are above the 105% collar may use the surplus to improve benefits. However, the improvement of benefits should not bring the plan below the 105% collar.

(f) Appendix B provides a detailed description of this mechanism.

3.4 Grow-in Benefits

QUESTION:
Should the legislation require grow-in benefits to be provided on plan wind-up?

ANSWER:

Currently, Nova Scotia's legislation makes providing grow-in benefits to members of plans that provide for subsidized early retirement benefits mandatory, so long as the members meet specific age and service requirements. Governments should permit, but not require, grow-in benefits. Where grow-in is a part of the plan, the cost must be reflected in the valuation.

In order to give employers (and unions, if applicable) the opportunity to choose if they want to continue with grow-in benefits, it is suggested that this change not be made active until the next collective bargaining agreement or, in any case, no longer than 5 years.. During this waiting period, there would be no requirement to fund for grow-in benefits.

Grow in benefits should receive equal treatment in the case of wind ups of underfunded plans.

3.5 Partial Wind-ups

QUESTION:
What should the regulatory position of Nova Scotia be with respect to partial wind-ups?

ANSWER:

The notion of partial wind-ups should be eliminated from the legislation.

The legislation should indicate that upon termination, whether one individual or a group, the employee(s) should be able to take the commuted value with him/her. If the withdrawal occurs while the plan is in deficit, the sponsor will be responsible for making up the deficit that was associated with the departing employee(s). This payment must be made by the next valuation date.

3.6 Unlocking

QUESTION:
To what extent should regulators attempt to regulate an employee's right to access funds?

ANSWER:

The Panel recommends that for DC plans, members before age 60 can have access to their **own voluntary** contributions, unless the plan itself is more restrictive. After age 60, employees can unlock both employer and employee contributions and do what they like with them. For example, they could convert them to another instrument such as an RRSP, LIF or RIF. The plan may include restrictions but must permit annuitizations in whole or in part at any time after age 60.

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

With respect to hardship issues, they should be removed from the legislation.

3.7 Governance

QUESTION:
Should government attempt to define, audit, and regulate "good governance"? Why or why not? Is so, what types of governance issues should be regulated?

ANSWER:

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

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

(b) The Superintendent shall be satisfied that the Governance Plan meets the generally accepted practice in the Pension Industry and may reject Governance Plans which fail to meet this test. Continued failure may result in the Superintendent taking action with respect to the plan.

(c) The Administrator shall certify in its annual filing that the Governance Plan that has been filed is being complied with, and if it has been altered, what are those alterations.

(d) Changes to the Governance model which are approved by the Advisory Committee or the Union, Trustees, as the case may be, shall be automatically approved by the Superintendent unless significant abnormalities exist.

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

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

3.7.1 Advisory Committees

The current legislation allows employees in plans of over 50 members to set up an Advisory Committee, whether an employer supports it or not. However, there are many plans that do not utilize them. One reason for this could be that currently, Advisory Committees have little power to influence sponsors. Advisory Committees are and should remain voluntary, but they should be given greater ability to influence sponsors and regulators. Specifically, Advisory Committees should be given, simultaneously, any information the sponsor files with the Superintendent, subject only to privacy laws. Advisory Committees should also be entitled to have reasonable access to plan actuaries and other professionals, so that they can communicate with them independent of the sponsor. The plan would be responsible for funding the costs associated with consulting professionals.

The Panel believes that there are many situations in which plan sponsors and the Superintendent could benefit from the use of Advisory Committees. For example, in the case of plan amendments, agreement to the amendment by the Advisory Committee could enable the Superintendent to simply accept the amendment providing that it does not conflict with the regulations. Without the agreement of an Advisory Committee the regular, longer process for approval of amendments would be required.

A second benefit would be to limit the liability of the sponsor in some instances. For example, having an Advisory Committee review and approve the list of investment options, including the default option, available in DC plans could reduce the liability of the sponsor as the Advisory Committee would be involved in speaking for the interests of the employees.

A third benefit for sponsors would be that they would no longer be required to disseminate information concerning plan operations and funding status to each individual employee. The sponsor would provide information to the Advisory Committee, who would in turn provide it to the employees.

The representatives on Advisory Committees should be elected by the employees. Advisory Committees need orientation and training. Training and providing support to Advisory Committees should be part of the mandate of a promotion division within the Department of Labour and Workforce Development.

3.8 Role of Regulators

QUESTION:
Does the current regulatory system work effectively? Are there currently unnecessary rules and regulations in place? If so, what are they? Should the appeal process be changed? If so, how?

ANSWER:

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

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

QUESTION:
Should a plan have a minimum number of members before the government will regulate it? If so, what minimum number of members would be appropriate?

ANSWER:

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

Act. Connected persons are people who own capital stock of the employer or are highly paid employees. These individuals do not need the protection of the *Pension Benefits Act*, and should not be regulated.

3.9 Harmonization

QUESTION:
What role, if any, should harmonization play in pension reform?

ANSWER:

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

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

3.10 Safe Harbour

QUESTION:
Should "safe harbour" rules be established that would give DC plan sponsors and administrators protection from litigation?

ANSWER:

To put "safe harbour" rules in place would be impractical and harmfully prescriptive. In the case of DC plans, plan sponsors should establish default investment option and contribution rates for those employees who cannot or choose not to select them themselves. In establishing a default investment option and contribution rate, the plan sponsor should act prudently.

We believe that DC plans should be required to provide to employees each year a statement of what pension they can expect to receive under several investment return and interest rate scenarios. This will provide employees early warning about potentially inadequate benefits and will often encourage higher savings rates.

3.11 Phased Retirement

QUESTION:
What should the regulatory position of Nova Scotia be with respect to Phased Retirement?

ANSWER:

The legislation should permit phased retirement—that is, it should not prevent the accumulation of new benefits while receiving a pension. This means that members could continue working at the same or a different job with their employer and accrue additional benefits while receiving part or their entire pension. There would be appropriate actuarial adjustments where needed to recognize the later receipt of the deferred and additional pension benefits.

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

3.12 Vesting

The Panel recommends that vesting in a plan be immediate.

3.13 Classes

Currently, Nova Scotia legislation includes a list of acceptable classes. For example, casual employees are not permitted to be members of a pension plan.

This list should be removed. Employers should be allowed to make their own decision on classes of employees, and benefit design for each (subject of course to any agreements arising from collective bargaining). However, the classes should be reasonable and sponsors would be required to file the classes with the Superintendent of Pensions. If the Superintendent considers a class arbitrary and unreasonably discriminatory he/she will take appropriate action to rectify the situation.

3.14 Access to Information

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

Everything that a sponsor files with the Superintendent of Pensions should be provided simultaneously to Advisory Committees, or where they do not exist, to employees via a place where the information can be easily accessed in both paper and electronic format. The Advisory Committee or Trustees of a joint Employer-Employee Trusteed Plan must make all information available to the members.

Advisory Committees should have reasonable access to professional advisors, such as actuaries, which are paid for by the plan.

3.15 Promotion

3.15.1 Promotion

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

The promotion of the proposed province wide plan and the training materials and programs in support of Advisory Committees could be a part of the mandate of such a promotion division.

3.15.2 Investments

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

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

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

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

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

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

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

4.0 Appendices

Appendix A: Definitions

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

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

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

Defined Benefit pension plan - Plan under which the pension is determined by a formula, usually based on earnings and years of participation.[3]

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

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

Multi-employer plan - a pension plan established and maintained for employees of two or more employers who contribute or on whose behalf contributions are made to a pension fund by reason of agreement, statute or municipal by-law to provide a pension benefit that is determined by service with one or more of the employers, but does not include a pension plan where all the employers are affiliates of each other.[4]

Surplus – is the excess of assets over liabilities.

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

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

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

Appendix B: Details on Minimum Funding

<u>Proposed Minimum Funding Standard for Defined Benefit Pension Plans</u>

The following documents, for discussion purposes, a proposed new minimum funding standard for defined benefit pension plans. The key elements are as follows:

1. Application

a. The proposal is for a minimum funding standard applicable to single employer defined benefit pension plans, though its principles are easily extendible to multi-employer and ACB benefit plans. It does not (and is not intended) to preclude the establishment of funding policies that result in the accumulation of assets or the establishment of contribution rates in excess of prescribed minimums.

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

    1) The "minimally funded benefits" are those that have been *accrued* to the date of measurement (i.e., the actuarial valuation date).
    2) Accrued benefits are normally described in terms of *units of pension*, accumulated (or "accrued") over time, plus *ancillary benefits* that may be attached to the basic pension. Ancillary benefits include early retirement subsidies (such as the opportunity to retire before Normal Retirement Age, either without reduction in the accrued pension, if certain criteria are met, or a better-than-actuarial-reduction otherwise), survivor benefits, death benefits and post-retirement indexing.
    3) Where the ultimate pension is a function of future wage increases, ***minimum funding*** will consider benefits accrued to the valuation date, plus provision for projected wage increases over the following 5 years. It is assumed that plan sponsors will, via their funding policies, make appropriate projections of the pensions the plan might ultimately pay, and fund accordingly.

2. *Method*

a. The actuarial cost method to be used is a modification of the projected accrued benefit method. “Projected” applies only to plans whose pension benefit is a function of earnings beyond the valuation date (i.e., “final average” or “best average” earnings plans, as opposed to career average or flat benefit plans).

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

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

d. Actuarial liabilities will be projected for each of the 5 years following the valuation date, including, in “final average” or “best average” earnings plans, a projection of both service and wage increases. The MFCSC will be calculated as the average percentage of salary required to fund benefits accruing during the five year period subsequent to the valuation date.

e. All ancillary benefits, including indexing and early retirement “subsidies”, are to be included in the liability calculation. With respect to the latter, utilization of early retirement subsidies, as determined by individual plan experience, should be reflected, regardless of whether individual plan members have met plan-mandated eligibility requirements as at the measurement (or valuation) date. [For example, if a plan offers to pay a member’s full accrued pension at age 55 as long as they have 30 years of service, then minimum funding for a member aged less than 55 should reflect the probability that they will be able to take advantage of this offer, even though they have not yet met the eligibility criteria as at the valuation date.]

3. *Assumptions*

a. *Discount rate(s)*
The discount rates will be:

1) The rates determined in accordance with the Canadian Institute of Actuaries' (CIA) *Educational Note* re Assumptions for Hypothetical Wind-up and Solvency Valuations, effective as at the valuation date,
2) plus
   a) 1.5% in respect of active members, until assumed retirement date, and
   b) 0% thereafter, and 0% in respect of pensioners

b. *Salary scale*

For the purpose of determining the MFCSC in "final average" or "best average" earnings plans, the salary increase assumption could be tied to the change in average wages (e.g., CANSIM II V1597104, which is the series used in the CIA's annual production of Economic Statistics) for the year ending in the month in which the valuation is being done.

c. *Mortality*

Per the CIA *Educational Note* referenced above, or the CIA's commuted value standard (which are generally expected to be the same).

d. *Terminations*

None

e. *Retirement*

Scale of decrements based on plan experience, but should assume that not less than 50% of those benefiting from retirement subsidies retire at the most expensive date.

4. Asset valuation

a. All assets to be valued at market.

5. Results

a. Assets > Liabilities x 1.05

Minimum funding = MFCSC minus (Assets – Liabilities) / 8

b. Liabilities x 1.05 > Assets > Liabilities x 0.95

Minimum funding = MFCSC

c. Assets < Liabilities x 0.95

Minimum funding = MFCSC plus (Liabilities - Assets) / 8

Comments re the results:

What is described here determines the minimum amount that must be contributed in a particular year. If the subsequent valuation shows an increase in deficit, the added deficit is to be amortized with a new schedule, stacked on top of the previous. In certain circumstances (for example if employees are contributing to the deficit amortization) the amortization may be delayed for up to one year from the valuation date. If so the amortization factor becomes 7.

6. Sources of funding / influence of funding policies

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

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

7. Other elements of funding

a. Terminations

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

- For those instances where a commuted value is paid, the commuted value would be calculated in accordance with the valuation standard described herein.
- They should be paid the full commuted value, regardless of the funded status of the plan, ***but*** "top-ups" need to be fully funded by the time of the next valuation, as opposed to being

considered part of a deficit and amortized. A “top-up” is the difference between the full commuted value and the commuted value times the plan’s funded ratio (so, for example, if a plan with a 90% funded ratio paid a commuted value of $100,000 to a member, there would be an obligation on the employer (unless completely jointly funded) to pay $10,000 into the plan not later than the next valuation, and before the determination of surplus or deficit. This is different than current legislation, which would require payment of the balance over not more than 5 years).

- Currently, members who terminate more than 10 years before the plan’s normal retirement date can retain the right to a deferred pension. The Panel is not proposing that this would change.

- Currently, members who terminate within 10 years of normal retirement may be compelled by the plan to take a pension (i.e., no commuted value option). The Panel is not proposing that this would change.

b. Partial wind-ups

By calling for the payment of 100% of commuted values on termination, combined with a minimum funding regime that recognizes all benefits including ancillaries and allows for employee participation in contribution holidays, the Panel believes there would not be a need for “partial wind-ups” as they exist currently.