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November 20, 2008

CONFIDENTIAL

Pension Review Panel
c/o Nova Scotia Labour and Workforce Development
Policy Division
PO Box 697
Halifax, NS B3J 2T8

Dear Sirs:

RE: Comments on the October 17th Position Paper

We have read the Pension Review Panel's Position Paper with great interest and applaud the Pension Review Panel for their work, which we believe has real value. In this letter, we are pleased to provide comments on behalf of Morneau Sobeco in our respective capacities as Chief Actuary of Morneau Sobeco and Managing Partner of the Halifax Office's pension practice. With over 2,300 employees, Morneau Sobeco is the largest Canadian-owned actuarial and human resources consulting firm. We are the also largest such firm in Atlantic Canada, with major offices in Halifax and Fredericton as well as an office in St. John's. The comments made in this submission are meant to supplement our previous submissions to the Panel dated July 4, 2008 and July 25, 2008.

The Position Paper outlined four goals for pension legislation: 1) security of the pension promises, 2) access to information, 3) transparency of information, and 4) promotion of pension plans. We would question the order of your four goals. As the Position Paper notes, "The Panel could find no instance of a true new private sector pension plan being implemented on a defined benefit basis in the last ten years." Given the extremely low percentage of Nova Scotians currently with pension coverage, we believe that the fourth-mentioned goal should be the primary goal. If plans ceased to exist, the other three goals would become academic. In addition, the second and third goals (access to information and transparency of information) can probably be combined into one goal.

Impact of the Recommendations

While we are prepared to endorse some of the recommendations, there are others that we feel will ultimately discourage plan sponsors from continuing to provide pension coverage, given their potential to either increase costs or complexity or both. As such, we seriously question whether the recommendations will arrest the long-term decline of defined benefit ("DB") plans. In any event, streamlining regulatory rules is only a small part of the problem. Plan sponsors in the private sector are closing off, or converting, their DB plan benefits primarily because of the volatility in their pension costs, not the administrative

burden. This after all, is a global phenomenon. The recommendations do not do much to mitigate volatility.

The one recommendation that can have a significant impact is the creation of a province-wide plan. Such a plan would almost certainly have to be a defined contribution arrangement. While a province-wide plan would be a positive development from a coverage perspective, it would not do anything to encourage DB coverage and likely would accelerate the decline of DB plans in the private sector.

We understand the Panel's interest in keeping the submissions brief. Accordingly, we have tried to limit our comments only to those areas where we have substantive comments to make.

Section 3.1.1 Adjustable Contribution / benefit Plans

One of the questions posed in the Position Paper is whether DC members should have the ability to use different disbursement options, such as LIF type payments, rather than be required to convert funds on their retirement date. We believe that the legislation should allow, but not require, plans sponsors to offer different disbursement options. A plan sponsor offering a flexible LIF type payment option would face additional, long-term administration costs.

Section 3.2 Province Wide Plan

Overall, we believe the idea of a provincial plan is positive and could increase pension coverage because of its cost efficiency and reduced administrative burden. It would appear the only practical plan of this nature would be a DC Plan. While we recognize that the Panel is taking the position that it does not favour one type of plan over another, they may unwittingly be doing so. In particular, increased governance and additional administrative requirements for DB plan sponsors would further accelerate the decline of DB plans in the private sector. It would be important that the cost of the managing agency be manageable.

A key component of a successful province-wide plan is to ensure that it be flexible enough to accommodate different contribution levels.

Section 3.3 Funding

The Panel recommends a new minimum funding valuation basis in lieu of the current going-concern and solvency valuations. This new basis appears to be similar to a hybrid of a solvency basis and a going-concern funding basis, given that salary projection is limited, no turnover is assumed, and there are restrictions on the choice of retirement rate assumption and discount rate.

This change would ultimately make the actuarial valuation process even more complex than it is today. If the requirement for a solvency valuation was removed, it would only be a matter of time before a pension plan terminated that was fully funded on this new minimum basis, but that had a deficit on a wind-up basis. If the sponsoring company was insolvent and could not make up the shortfall, the plan members would suffer and the province would be under great pressure to reinstate the requirement for a solvency valuation. We would then revert back to at least two valuations: the new minimum funding basis and the

solvency valuation. We believe it would be better to make solvency valuations the only required valuation for regulatory purposes (possibly with a provision for adverse deviation).

We have reviewed the impact of the proposed valuation method on a few of our clients. In one situation, the new minimum funding rules would result in the tripling of the minimum required contribution relative to the current rules. Furthermore, the new minimum contribution would represent about 60% of covered payroll. This is obviously a material issue for any company and would contribute to the demise rather than the promotion of defined benefit pension plans. (It could even contribute to the demise of certain companies.) It is important to keep in mind that pension plans in non-unionized workplaces were established on a voluntary basis by employers based on a given set of pension regulations. To alter the regulations in a manner which would triple an employer's contribution requirement to a voluntarily established arrangement is simply unfair.

In addition to the severe impact on plan sponsors, we are concerned that the proposals for the minimum funding valuation are too radical, and moving away in this fashion from the accepted practice in all other provinces is not warranted. The current solvency test has its merits and, given the fact that legislation requires plans to be fully funded on wind up, we feel that retaining a solvency valuation with adjustments to the amortization period (lengthening to say 8 or 10 years) would be more appropriate.

We do not agree with the statement that plans in deficit should not be permitted to improve their plans. The vast majority of plans which make changes while in deficit have the full intention and ability to fund the deficit over time in an orderly fashion.

Finally, we believe that where plan sponsors have established long term budgets based on the current solvency rules, it is unreasonable to impose potentially stricter funding standards immediately (i.e. without a grace period).

Section 3.3.1 Amortization

We agree that it is appropriate to introduce the concept of a "collar", given that the proposed rules will not allow for asset smoothing. However, we believe that 10% may be a more appropriate collar before amortization payments are required. We also note that the Position Paper refers to a fixed three year schedule for valuations. We assume there will be some flexibility to allow plan sponsors to perform earlier valuations where circumstances warrant (i.e. significant amendments to the plan, etc.).

Section 3.3.2 Surplus

The Panel would prohibit employers from withdrawing surplus. The reason given is that employees might ultimately bear some funding risk. In our opinion, this risk is mostly theoretical (few private sector employers ask the employees to make up a deficit) and in any event it is not a good enough reason to perpetuate surplus asymmetry. Ostensibly, a surplus withdrawal could be followed by adverse experience that could cause the plan to fall into deficit, which would make the surplus withdrawal seem inappropriate. If this is the argument, it creates a double standard, with employers who historically funded conservatively being measured to a higher standard than employers who chronically underfund. If

a funded level of 100% is sufficient for a plan that is currently in deficit, it should also be sufficient for a plan that is currently in surplus.

We agree that if employees are prepared to shoulder half of any deficit, they should also benefit from half the surplus. Plans with this sort of funding policy, however, are rare at present. Still, if the employer could get plan members to agree to deficit sharing, then sharing of contribution holidays (i.e. minimum 50% credited to employees) would appear to be fair. If plan members refused to agree to take any responsibility for deficits, however, it is not reasonable to restrict the employer's right to surplus to 50%. The employer's right should not be restricted to wind-up situations, as opposed to an ongoing plan. This would encourage wind-ups.

The Position Paper also stipulates that any surplus up to 105% solvency funding cannot be amortized. This position should be clarified, since the Position Paper took an earlier position that recommended that solvency valuations should no longer be required. Presumably, the reference to solvency funding should have been a reference to minimum funding.

Section 3.4 Grow-in Benefits

The recommendation to eliminate mandatory grow-in benefits is welcome. However, if the proposed change to move toward a hybrid of both a solvency and going-concern funding basis is adopted, then it would appear that grow-in benefits would implicitly be partially accounted for in the valuation as the proposed funding basis makes allowance for a proportion of the membership to retire at the earliest unreduced age. As such, we question as to how both recommendations can be implemented.

Moreover, it is difficult to reconcile this recommendation with the suggestion that the change not be made immediately. There is no good reason to have to wait up to five years for the change. We note there was no 5-year grace period to implement grow-in in the first place.

Section 3.5 Partial Wind-ups

We agree that partial wind-ups should be eliminated from the legislation.

In regards to members terminating and commuting their benefit while a plan is in a deficit position, we have a concern with respect to the requirement to make up any deficit for that member by the next valuation date. In cases where the termination occurs just before the valuation date, it may be too onerous to require the plan sponsor to fund the deficit in such a short period of time. We recommend that there be a window of time where a plan sponsor is permitted to defer the deficit payment until the subsequent valuation if the withdrawal occurs within a certain time from the next scheduled valuation.

Section 3.6 Unlocking

We are in favour of continuing the current approach of having benefits locked-in given that one of the overarching purposes of pension plans it to provide income security in retirement. Moreover, the Panel's proposal would result in inconsistent treatment between DB plans (where benefits would be locked-in) and DC plan (where benefits wouldn't be locked-in). All types of plans should be subject to the same

locking-in rules. We also fail to understand the seemingly arbitrary selection of age 60 as the "unlocking age".

A possible middle-ground solution would be to adopt a New Brunswick-style approach where a certain percentage of the commuted value of a benefit (linked to a multiple of the annual allowable distribution from a LIF) could be unlocked with the balance remaining locked-in. We believe that DB and DC plan members should be afforded equivalent unlocking opportunities

Section 3.7 Governance Plan and Advisory Committees

It is not clear what would constitute "good governance". More guidance from the Panel would be welcome concerning the Governance Plan. The danger with a Governance Plan idea is the same as with Statements of Investment Policies and Procedures: They can be useful working documents if applied in good faith but they could equally become a nuisance compliance requirement with little practical use.

Since the Panel is not intending on legislating any specific governance standards, then there may be some uncertainty as to the specific standards that a plan sponsor must meet.

Similarly, more information on Advisory Committees would be useful. Many questions remain—for example: Should an Advisory Committee include both retired members and active members? Would representation from the ranks of senior management be permitted or encouraged? How would the regulations define the Committee's responsibility to inform the membership and to ensure the Committee is accountable? How would the Committee's approval of amendments work? Would the employer lose its current rights to its advisory committee under the existing legislation? What liabilities, or protections, would result for those who serve on a Committee? What will be the extra cost of a Committee, compared to the utility? Should Committees be restricted to situations where the plan membership has agreed to some form of risk-sharing or cost-sharing with the employer (including sharing of deficit-funding)?

There are also significant potential conflict of interest and cost issues in allowing Advisory Committees unfettered access to plan actuaries and other professionals.

Ultimately, we fear that mandatory Advisory Committees with real powers would be complicated to regulate and would further discourage pension plan coverage.

Section 3.8 Role of Regulators

We agree with the recommendation that the Nova Scotia Labour Relations Board should hear appeals from decisions of the Superintendent.

Section 3.9 Harmonization

The Panel's proposal to harmonize legislation is practical and sensible, but of limited value if other provinces do not agree. The overall administration burden for multi-jurisdictional plans will continue to be problematic if other provinces do not follow Nova Scotia's example. Given the recently released CAPSA document, it seems unlikely that the other provinces will follow suit.

With regards to the minimum number of members in a pension plan before it would fall under the jurisdiction of the *Pension Benefits Act*, we believe that there should be no minimum. Further, having no minimum maintains a level playing field for all plan members.

Section 3.10 Safe Harbour

We agree that "safe harbour" rules are not necessary. However, requiring DC plans to provide employees with a statement of what pension they can expect to receive under several investment return and interest rate scenarios seems somewhat unnecessary and we question how useful this will be given the number of variables involved with any such calculations. It may be more useful to encourage plan sponsors, as part of good governance, to give members access to investment planning tools that allow them to see various pension scenarios based on the information the member inputs.

Section 3.11 Phased Retirement

We agree that the *Pension Benefits Act* should permit, but not require, phased retirement.

Section 3.12 Vesting

We do not see the need to change the existing vesting rules. In some companies, turnover in the first two years of employment can be very high. Immediate vesting would greatly expand the administrative burden for those companies, because of the extensive paperwork that is required whenever a vested employee terminates membership. This additional work would not produce a significant benefit for most employees who terminated with short service. We believe that the focus of an employer-sponsored pension plan should be on longer service employees.

At a minimum, if this recommendation were implemented, the plan administrator should be allowed to pay out the benefit in cash at its discretion if the benefit is small (for example, on the same basis that is used for the small pensions rule). The plan administrator should not have to administer a minimal deferred pension for decades or have to wait for the employee to complete all the paperwork before transferring the member's entitlement out of the fund.

Section 3.13 Classes

Existing lists of allowable member classes are too restrictive or too vague in some situations. The alternative of letting employers decide on classes, however, is potentially chaotic and prone to abuse. At a minimum, there should be some guidelines for what type of classes might be deemed unacceptable.

Section 3.14 Access to Information

We are living in an electronic age. Company intranets and employee benefit websites are becoming the norm. This would be a good time to shed the age-old requirement to provide information in paper format, where electronic information access is available to the intended audience.

Section 3.15 Promotion and Investments

We are in general agreement with the Panel's recommendation with respect to public promotion of pension plans.

Thank you for the opportunity to provide our input to the Panel. We would be happy to provide clarification on any of the above points.

Yours truly,

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