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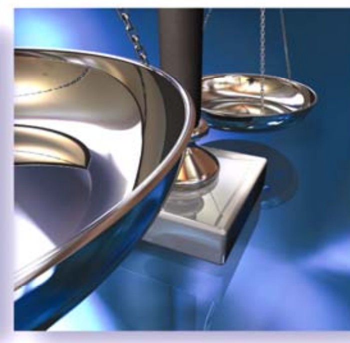

Report of the Joint Expert Panel on Pension Standards

Panel Members:

Christopher Brown, Alberta Co-Chair
Scott Sweatman, British Columbia Co-Chair
John Davies
John Gilfoyle
Elaine Noel-Bentley
John Tackaberry

Additional copies of this report can be obtained from and enquires may be directed to:

Room 402, 9515 – 107 Street
Edmonton AB T5K 2C3

PO Box 9418 Stn Prov Govt
Victoria BC V8W 9V1

Website: http://www..ab-bc-pensionreview.ca/ (until May 15, 2009)

Alberta/British Columbia
Pension Standards Review - *Joint Expert Panel on Pension Standards*

Room 402, 9515 - 107 Street
Edmonton AB T5K 2C3

PO Box 9418 Stn Prov Govt
Victoria BC V8W 9V1

Phone: 1-888-568-9924
Fax: 1-866-568-9924

November 14, 2008

Honourable Iris Evans
Minister of Finance and Enterprise
Province of Alberta
208 Legislature Building
10800 - 97 Avenue
Edmonton AB T5K 2B6

Honourable Colin Hansen
Minister of Finance
Province of British Columbia
PO Box 9048 STN Prov Govt
Victoria BC V8W 9E2

Dear Minister Evans and Minister Hansen:

We are pleased to deliver the report of the Alberta / British Columbia Joint Expert Panel on Pension Standards.

The pension system in Alberta and British Columbia is not working well for the majority of Albertans and British Columbians. Pension coverage levels in the private sector continue to decline to alarmingly low levels. The costs and complexities of compliance are posing significant hurdles to the establishment and maintenance of pension plans. It is clear that a fundamental reform of pension legislation is urgently needed to address these issues.

The Panel applauds the governments of Alberta and British Columbia for undertaking this joint review. Our consultations show that the stakeholder community is also impressed with your collaborative approach. Those of us in the pension community urge you to seize this historic opportunity to move the system forward by making positive change.

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Accordingly, we strongly recommend that our two governments take a leadership position in pension reform by moving quickly to:

- fix and harmonize pension standards legislation in our provinces; and
- establish a steering committee to develop and implement a joint Alberta/British Columbia Pension Plan.

The Panel believes our recommendations will provide a solid foundation for pension plans over the long term. However, recent events in the economy demonstrate that the governments should use their power to provide temporary relief when extraordinary circumstances adversely affect pension plans.

The pension system is comprised of a number of divergent competing interests. In reaching our recommendations, the Panel has attempted to strike a balance. While not everyone will support each recommendation, we strongly encourage all stakeholders, including the governments, to view these recommendations as an integrated package.

We recognize that the challenges facing the system extend beyond our borders, and national action is desirable. However, you should not wait for other governments to act. This joint effort uniquely positions you to take the lead in pension reform in Canada.

We hope that this report will constitute an important first step to foster the growth, health and viability of the pension system in Alberta and British Columbia.

Respectfully submitted,

Christopher Brown
Co-Chair

Scott Sweatman
Co-Chair

Elaine Noel-Bentley

John Davies

John Tackaberry

John Gilfoyle

Executive Summary

The Joint Expert Panel on Pension Standards was appointed on October 19, 2007 by the Ministers of Finance of Alberta and British Columbia to conduct a full and independent public review of the pension standards legislation in the two provinces with a view to ensuring that the pension benefits standards contribute to making our provinces leaders in creating opportunities and choices for workers, investors and businesses. The *Pension Benefits Standards Act* (British Columbia) and the *Employment Pension Plans Act* (Alberta) (the Acts) set minimum standards for funding, investments, benefits and disclosure for occupational pension plans. Almost 1600 pension plans in the two provinces are subject to these standards. Public sector plans were excluded from the review.

The two Acts have not been thoroughly reviewed for two decades. During that time the occupational pension system has matured and become more complex, and pension plan participation has declined significantly in the private sector. Therefore, the Panel's key objective was to recommend changes that would strike a balance between encouraging the establishment and maintenance of workplace pension plans and giving plan members confidence in the security of their pension benefits.

The appointment of a joint Panel provided an opportunity to explore prospects for greater harmonization of pension standards between the provinces, responding to frequent calls for greater interprovincial harmonization.

The Panel has concluded that a fundamental reform of pension legislation is necessary to address these objectives. In crafting our recommendations we have attempted to balance the disparate views and interests of plan beneficiaries and employers, and the potentially contradictory goals of improved benefit security and higher participation. Consequently, we urge all readers of our report to view our recommendations as a package, which is intended to be taken as a whole.

Panel Recommendations

Following are our key recommendations:

Legislative framework

The governments should have as a stated public policy objective the encouragement of occupational pension plans as part of the "second pillar" of the retirement income system, complementing government programs and individual savings. This objective should not be included in pension standards legislation or in the Superintendent of Pensions' mandate; rather, the governments should jointly create the position of a "pension advocate", who would be responsible for promoting pension coverage generally.

Standards should accommodate a wider variety of pension arrangements than were contemplated in the current statutes and should be tailored to the key characteristics of different types of pension plans – especially, to the risks associated with those different types of plans. At the same time, they should continue to promote transparency, accountability and benefit security. The legislative framework should be designed to be more principles-based, relying on principles where possible and rules where necessary. Strength and flexibility can best be achieved by articulating broad principles in the legislation, backed up where necessary by specific rules.

More principles-based legislation will necessitate equipping the regulator with the discretion and resources to enforce the principles effectively:

- the discretion to approve a variety of plan arrangements as long as they are consistent with the principles, and to issue guidelines specific to new plan arrangements
- the power to review and require changes to plan governance
- the power to impose administrative penalties for failure to provide key information that enables the superintendent to exercise his oversight role, and for failure to perform key administrative duties such as making contributions or providing benefit statements

The Panel recommends that, in order to promote and maintain harmonization, the two governments:

- adopt identical Acts in each province;
- establish a joint policy advisory council and a joint pension tribunal; and
- work toward the establishment of a joint pension regulator for the two provinces to administer the harmonized statutes.

In addition to their roles in maintaining harmonization:

- the joint pension tribunal would hear appeals of regulator decisions in both provinces to act as a "check and balance" to greater regulator discretion; and
- the joint policy advisory council would advise the ministers and the regulators in both provinces on policy and administrative issues. The council would be comprised of government policy advisors, private sector pension experts and the regulator(s).

We also urge the two governments to work toward national harmonization by championing the establishment of a national council of ministers responsible for pensions that would have a mandate to consider the viability of harmonized or uniform pension standards regulation across the country and a single national regulator.

Promoting confidence in the pension system

When pension plans fail to deliver on their promises, poor governance is often a root cause. In keeping with a more principles-based regulatory system, we recommend that:

- the widely-accepted "best practice" standards developed by Canada's financial regulators for governance and for capital accumulation plans be adopted as principles in the legislation, and that the regulator be given discretion to assess plans accordingly and require remedial action if necessary;
- pension plans be required to have a governance policy, which includes a funding policy if the plan contains a target or DB provision, and to disclose it to members;
- current rules imposing quantitative limits on investments be repealed, making investments subject to the "prudent expert" standard, except that statutory limits on related party transactions should be retained;
- the statute clarify that fiduciaries in making investment decisions must make those decisions in the best financial interests of plan members and can take nonfinancial matters such as environmental, social and governance factors into account only as they affect the potential risk and return of the investment;
- individuals having statutory fiduciary responsibility be required to complete training programs at post-secondary institutions; and
- plan fiduciaries be provided a statutory defence if they can demonstrate that they have adhered to the governance guidelines and have acted in good faith, on an informed basis, in the interests of the beneficiaries, and in the absence of conflicts of interest.

Minimum funding standards should be tailored to the nature of the "pension deal", the details of the pension promise that is reflected in the plan terms.

To overcome the impasse resulting from uncertainties about ownership of surplus in traditional DB plans, and its negative effects on the funding of these pension plans, the principles of the regulatory system should recognize that the promise that requires protection is the defined benefit rather than the contributions or surpluses that may arise. The Panel recommends:

- allowing pension plan sponsors to contribute funds in excess of those required on a going-concern basis to a separate fund (a "pension security fund") from which amounts in excess of the calculated "wind-up basis", after building in a reasonable margin, could be withdrawn by the sponsor;
- "ring-fencing" surplus ownership issues by allowing pension plan sponsors to "freeze" existing plans, preserving any existing entitlements to surplus and ensuring that accrued rights such as vesting continue, and to start new plans whose terms and conditions with respect to surplus entitlements would be clearly set out;

- continuing to allow irrevocable letters of credit issued by financial institutions to cover solvency deficiencies, as is currently allowed in both provinces;
- requiring surplus withdrawals or employer contribution holidays to be spread over five years with annual valuation updates to confirm that the plan continues to be in surplus to protect members from the volatility of pension valuations due to changes in economic factors such as interest and inflation rates;
- that the governments of British Columbia and Alberta encourage the federal government to review all of the income tax limits related to pension plans. The Panel recommends in particular that the limit on surplus that can be held in a pension plan be raised to 125 percent of liabilities; and
- that the governments encourage the federal government to extend the "super-priority" for unpaid pension contributions, contained in federal bankruptcy and insolvency legislation, to include due but unpaid special payments for solvency deficiencies and unfunded liabilities.

A new set of funding, disclosure and benefit rules is recommended for "specified contribution target benefit" plans, where the contributions are fixed by collective bargaining or a similar method but benefits are provided based on a formula:

- The plans' funded status would be measured and any adjustments made on a going-concern basis. The plans would no longer have to prove that their assets would cover liabilities in the event of plan wind-up ("solvency basis"), but additional protections would replace the solvency funding rules:
  - There would be a requirement to hold a sufficient cushion to protect against unfavourable events, and a requirement to report the "settlement" status of the plan (whether the plan could pay out all benefits with existing assets) to the regulator and disclose it to members along with an explanation of the implications.
  - Benefit improvements would be restricted unless the plan has a sufficient funding cushion.

The Panel believes its recommendations for minimum funding rules would provide a solid foundation to promote benefit security in pension plans for the long term. However, recent events in the economy demonstrate that the governments should continue to use their power to provide temporary relief by easing funding standards in exceptional circumstances affecting all pension plans.

Individuals and the pension system

The Panel recommends that:

- the governments enhance and expand the financial literacy component of their high school curricula;

- the governments establish a clear mandate within government for enhancing financial literacy in the adult population; and
- the rules governing "unlocking" of pension monies that have been transferred out of a plan by a terminating employee be harmonized in the two provinces and that unlocking of 50 percent of pension funds should be allowed on a one-time basis if the owner is at least age 50, similar to Alberta's current rule. The Panel recommends that plan sponsors be allowed to require a greater degree of "locking in" as a term of their own plan.

Improving pension coverage

While a new generation of pension standards legislation is a necessary basis for a solid occupational pension system in the future, in our view it is not sufficient. Just over 20 percent of private sector workers in the two provinces are enrolled in pension plans. Employers often cite expense, administrative burden and risk as reasons why they do not offer pension plans. We advocate that the governments of British Columbia and Alberta create a new pension plan, to be operated as a non-profit entity at arm's length from government but regulated under the pension standards legislation. The Panel recommends that a Steering Committee be established, comprised of experts in all facets of pension plans to determine the feasibility of establishing such a plan, obtain public input and recommend the plan design

The following are the Panel's recommendations for the key characteristics of such a plan:

- The plan would be available to any employer, employee or self-employed person at a reasonable cost, enabling them to take advantage of the economies of scale afforded by pooling pension risks and assets as well as access to investment expertise and products not currently available to small pension plans and individual investors.
- Administration and investment management should be competitively tendered. To be successful, total expense ratios for this type of plan, including investment management and administration expenses, should not be greater than 0.5 per cent of assets under management.
- The plan would be a simple defined contribution plan, and enrolment would be automatic for employers and employees, who could opt out if they did not wish to participate. Self-employed people could participate by opting in.
- Employees and employers would not have any discretion with respect to the investment of plan assets, which would be invested subject to the policy direction of the board of governors.
- Provision of annuities from within the plan should be considered if the plan becomes large enough.

- Although some start-up costs would likely have to be financed by the governments, the governments would have no ongoing costs or liabilities. The plan would be subject to the same regulation as any other registered pension plan in the two provinces.

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1.0 Introduction and Overview

On October 19, 2007 the Ministers of Finance of Alberta and British Columbia took a historic step by appointing the Joint Expert Panel on Pension Standards (the Panel) to review pension standards legislation in the two provinces simultaneously, and to consult the public in both provinces, especially those who have a direct interest in the pension system: plan members, unions, employers, retirees, industry and labour groups and the service industry that supports the pension system. We have spent the last year doing just that, and have learned a great deal along the way.

The response to our call for public input was impressive and reinforced our belief that the shape and direction of the pension system is very important to Albertans and British Columbians. We assembled and synthesized all that we have heard, conducted additional inquiries and research to inform ourselves broadly on key topics, and chose our areas of focus carefully.

The governments asked us to make recommendations that are practical, affordable and feasible, and we have subjected all our recommendations to these basic criteria. We believe our recommendations meet short, medium and long-term objectives for pension standards, and strike a balance among all of the perspectives that should be represented in an optimal pension system, looking at both broad policy goals and specific areas for improvement in pension standards.

Occupational pension plans do not exist in a vacuum – they are voluntary arrangements operating in a competitive environment in an open economy. Another reality of that environment is that certain aspects of the economy are regulated for reasons of security and fairness, especially to protect vulnerable individuals. The occupational pension system must be understood in these two important contexts. Our recommendations are targeted at areas we believe will yield the most significant positive outcomes for the pension system.

We dedicate this report to the present and future citizens of Alberta and British Columbia, whose financial independence and security in retirement were always in our minds as we endeavoured to make recommendations for a pension system that will serve them long into the future.

1.1 Our mandate

The mandate of the Panel was very broad – to conduct a full and independent public review of pension standards in the two provinces, and make recommendations for sustaining and improving the pension system for Albertans and British Columbians – an ambitious goal that goes beyond preserving what is already in place.

The Alberta *Employment Pension Plans Act* (EPPA) and the British Columbia *Pension Benefits Standards Act* (PBSA) set minimum standards for occupational pension plans sponsored by employers and/or unions in the two provinces. The standards cover eligibility, benefits, investments, funding and disclosure to members. The Acts apply to private sector pension plans with members in the two provinces except those plans that are for workers in federally-regulated industries such as banking and telecommunications. In British Columbia, plans for public sector workers are also regulated under the PBSA, and therefore the standards, with some exceptions, apply to them. In Alberta, most public sector plans are not regulated under the EPPA. We make this point to clarify that this review is about standards generally applying to occupational pension plans that are subject to the Acts, not about the terms of any particular pension plan. Public sector pension plans were specifically excluded from the scope of this review.

It has been 20 years since the current generation of pension standards legislation came into effect in Canada, and 40 years since the first generation took effect. While many of the basic tenets of the legislation remain as relevant today as two or four decades ago, the maturity of the pension system and the evolution of the financial, demographic and employment environments have shifted the focus of the whole system in some significant ways. The problems in the system have complex and interrelated causes arising from the structure and competitive environment of businesses, the financial aspects of pension plans, demographic considerations, and the diverse interests of all parties to the system.

This review provided all interested stakeholders with a significant opportunity to provide commentary regarding:

- what is good in the current system and should be preserved;
- what is wrong with the current system and should be changed; and
- what other improvements can be made to the system now and for the future.

1.2 The Panel

Christopher Brown, Alberta Co-Chair

Mr. Brown, a lawyer, is a partner in the Calgary office of Osler, Hoskin & Harcourt LLP, Pensions and Benefits Department. He advises clients on a wide range of subjects, including pension plan governance, administration, compliance and investment. Mr. Brown has experience in the development of pooled funds and other structures eligible for investment of pension fund assets. He has been affiliated with the Alberta Council of the Association of Canadian Pension Management, the Canadian Pension and Benefits Institute, and the Canadian Association of Pension Supervisory Authorities Stakeholder Task Force on Common Pension Standards.

Scott Sweatman, British Columbia Co-chair

Mr. Sweatman is Senior Legal Counsel with the national firm of Blake, Cassels & Graydon LLP, specializing in pension, tax, trust and benefit issues and works out of the firm's Vancouver and Calgary offices. He has written and spoken on pension regulatory compliance, pension communication and disclosure, liability of the employer for group benefit coverage, pension surplus entitlement issues, and pension policies. Mr. Sweatman has served on a number of committees on pension issues including as past chair of the Canadian Pension and Benefits Institute and the Pension, Benefits and Compensation Section of the Canadian Bar Association (BC).

Elaine Noel-Bentley, Alberta Member

Until her retirement in March 2007, Ms. Noel-Bentley was Senior Director, Total Compensation at Petro-Canada, responsible for compensation, pensions, benefits and payroll. Ms. Noel-Bentley has previous experience as Managing Principal, The Alexander Consulting Group and Manager, Pension Services at Alberta Treasury. She has been active locally and nationally in professional pension organizations, and is a member of the Board of Trustees of the Alberta Local Authorities Pension Plan.

John Tackaberry, Alberta Member

Mr. Tackaberry, Business Manager of the International Union of Painters & Allied Trades Local 177, has over 25 years experience as a pension trustee. He sits on the Canadian Board of Trustees of the International Local Union and District Council Pension Fund and is the Co-Chairman on the Board of Trustees of the International Union of Painters & Allied Trades Local 177 Benefit Trust Funds. Mr. Tackaberry has also participated in numerous International Foundation of Employee Benefit Plans programs.

John Davies, British Columbia Member

Mr. Davies is an engineer and pension issues speaker/consultant, with extensive hands-on experience addressing pension problems in a unionized environment, for both multi-employer and single-employer plans. Mr. Davies has served as full time Chairperson of the Carpentry Workers Pension and Benefit Plans of British Columbia since 1999. During his tenure, he was responsible for both plans' restructuring from 1999-2003.

John Gilfoyle, British Columbia Member

Mr. Gilfoyle, a recently retired senior consultant with Watson Wyatt Canada in Vancouver, is an actuary and investment strategist, primarily responsible for developing investment policies for pension fund clients to ensure the delivery of pension promises. Mr. Gilfoyle is past Chairman of the Economic Statistics Committee of the Canadian Institute of Actuaries (CIA), was a member of the CIA Task Force on Financial Economics and has made presentations at seminars and conferences on investment topics as well as interviews for radio and television.

1.3 Terms of reference

The following are the Panel's Terms of Reference as set by the governments of Alberta and British Columbia:

The Panel will be accountable to the governments of Alberta and British Columbia for conducting a full and independent public review of the EPPA and PBSA. The Panel will make recommendations with a view to ensuring that the pension benefits standards contribute to making Alberta and British Columbia the leaders in creating opportunities and choice for workers, investors and businesses by:

- giving Albertans and British Columbians confidence in the security of their pension benefits;
- encouraging the establishment and maintenance of employment pension plans;
- ensuring fairness for both employees and employers, balancing risks and rewards;
- creating a level playing field and removing barriers to the creation and maintenance of pension plans by businesses and unions operating in Alberta and British Columbia; and
- being competitive with other jurisdictions.

The Panel will:

- publish a background discussion paper to assist respondents in creating submissions;
- establish its own rules for conducting its business, within the bounds of these Terms of Reference;
- call for and receive written submissions from stakeholders, internal or external;
- consult with the public according to an approved budget; and
- submit a written report of its findings to the governments, regarding recommended changes to the EPPA and PBSA, no later than September 30, 2008 ("Final Report").[1]

[1] The governments extended the due date to November 14, 2008.

The Panel will treat as confidential all information provided to the Panel and all information created by the Panel.

Despite the above, the Panel, upon notice to third party authors, may make public any third party submissions received by the Panel. The notice to third party authors of submissions must be set out by the Panel and publicized in advance of receipt of third party submissions.

The Panel is to consider:

- recommendations that are practical, affordable and feasible;
- the role of pensions in attracting and retaining the future work force and in facilitating worker mobility;
- benefits and protection of beneficiaries;
- minimum funding and ownership of surplus;
- investment standards;
- disclosure to members of pension plans;
- whether the EPPA and PBSA should move to a more principles-based legislative model;
- the legislative approaches in other jurisdictions and their potential applicability;
- opportunities for greater harmonization of pension benefits standards legislation on a national level;
- what standards are needed, if any, on governance of pension plans;
- implications for Memorandum of Reciprocal Agreement and regulation of multi-jurisdictional pension plans;
- the need for and feasibility of new pension models and if statutes require amending to remove impediments; and
- other legislative provisions that the Panel recommends be added, deleted, updated or otherwise amended.

1.4 The process

The Panel's first task was to determine how it would communicate and consult with the public. We wanted to elicit as much thoughtful response as we could, from as many different sources as possible. The complexity of the issues in pension regulation lends itself to a consultation focused on written materials.

We decided to frame the issues, as we saw them, in a discussion paper. The Panel published a discussion paper, *A Better Pension System for the Future: Finding a Balance*, on December 14, 2007, releasing it on our website and alerting about 2000 stakeholders of its publication by e-mail and regular mail.

Our paper began with a brief overview of the current economic, legal and demographic environment in which occupational pension plans exist. It then turned to broad pension policy issues including the role of the regulatory system itself. Finally, it highlighted certain specific elements of the standard about which concerns have been raised. The Panel invited written submissions by February 29, 2008.

The paper posed 39 questions, ranging from very general and philosophical questions about the place of pension plans in the retirement income system and the shape of the regulatory system, to very specific questions about particular standards. We asked these questions to stimulate thinking and generate responses. Not every respondent chose to answer all the questions – or any of the questions. From the responses, we were able to refine our focus to the areas causing the greatest concern and having the greatest impact on the future state of the system.

The Panel received and published 118 submissions on our website. After the response period closed, the Panel set up one-on-one meetings with over 40 stakeholder groups, in accordance with its mandate to consult with the public and its previously announced process (see Appendix A). These meetings were held in Calgary, Edmonton and Vancouver during March, April and May 2008. After this first round of meetings, the Panel analyzed all the written and oral information received and began to formulate our recommendations. We then conducted a second round of one-on-one meetings in late summer and early fall with a more limited number of stakeholder groups to gather additional information in some cases, and to receive feedback on some of our potential recommendations.

Recognizing that there were two other pension reviews ongoing during the course of our deliberations, the Panel also met with members of the Ontario Expert Commission on Pensions and of the Nova Scotia Pension Review Panel. We engaged in useful dialogue about the processes being followed by the three bodies and the matters being considered by each, although the terms of our respective mandates and the different timelines for our respective proceedings limited our ability to share final recommendations.

In addition to our direct responses from stakeholders, we turned our attention to the large volume of material that has been developed on pension issues, including other recent pension standards consultation processes. Discussion papers, research studies and hundreds of submissions comprise a virtual ongoing Canadian dialogue on pension matters, highlighting the need for modernization and alignment of pension standards in Canada. We used this work to assist us in reaching the best possible resolutions to these important issues.

1.5 Acknowledgements

Our knowledge and, we hope, our wisdom about the pension system has expanded considerably during this process. The single greatest source of that knowledge was the responses, both written and oral, from our respondents. We were extremely impressed and gratified at the quantity and quality of written responses we received. These responses were greatly enhanced and supplemented by the frank and thoughtful conversations we had with many of the respondents, and additional people who kindly agreed to assist our inquiries. We cannot overstate how valuable these responses were, and we are greatly indebted to all of you.

The Panel also wishes to acknowledge the important contributions made to our work by the coordinators appointed by the two governments to assist us, Ellen Nygaard from Alberta and Joann Cain from British Columbia. Their passion for our topic and dedication to the process were truly inspiring and helped keep the Panel on track throughout.

We would also like to thank the dedicated and competent staff members of Alberta Finance and Enterprise and British Columbia Finance who provided logistical, communications, administrative and research assistance to us and made our big job much easier.

We must also acknowledge the support and forbearance of family, friends and work colleagues who adjusted, accommodated and otherwise enabled us to concentrate on this task.

Finally, and on behalf of the entire pension community, we would like to thank and congratulate the governments of Alberta and British Columbia for launching this inquiry, supporting it, and allowing it to proceed with independence and integrity.

2.0 Background and General Policy Issues

2.1 Background

Some preliminary comments on the pension system in Alberta and British Columbia may be helpful to put the Panel's discussion and recommendations contained in this report in context.

2.1.1 The three pillars of the retirement income system

The Organization for Economic Cooperation and Development (OECD) classifies the various sources of retirement income into "three pillars":

1) government-administered pension programs
2) employer-sponsored occupational pensions
3) personal savings

The following is a brief description of the OECD pillars.[2]

Pillar 1

In Canada, the first OECD pillar – government-administered pension programs – is comprised of the Old Age Security (OAS), the Guaranteed Income Supplement (GIS) and the Canada/Quebec Pension Plans (CPP/QPP).[3]

These programs are structured to provide retirement income equivalent to 40 percent (15 percent from OAS/GIS, and 25 percent from CPP/QPP) of pre-retirement income, up to a limit of the national average wage.[4] Except for the very lowest income earners, who rely almost entirely on Pillar 1 government-administered pension programs, all three pillars are considered necessary for individuals to achieve a standard of living in retirement comparable to their pre-retirement situation. The system contemplates that most individuals will accumulate additional savings for their retirement through occupational pension plans and/or personal savings.

[2] The OECD classification system is one of a variety of systems for categorizing retirement income. Although we describe the OECD pillars here, the Panel does not take a position as to the best classification system.
[3] Although Canada Pension Plan is classified under Pillar 1 under the OECD classification system as a government-administered program, it is considered by many to be part of Pillar 2 – occupational pensions.
[4] Handbook of Canadian Pension and Benefit Plans – 12th Edition – revised by Jennifer Greenan.

The OAS/GIS is financed through general tax revenues on a pay-as-you-go (PAYG)[5] basis, the CPP/QPP in partially funded from contributions based on employment earnings (the target is 25 percent funding) and Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs) are funded. The most recent actuarial report of the CPP comments on the diversified funding methods in Canadian systems:[6]

> This variety in funding methods enables the system to be steered towards more or less funding by putting emphasis on the different tiers depending on the demographic and economic conditions.

Pillar 2

As far back as the early 19th century in Canada, informal pension plans were available for employees who could no longer work. By the end of the century, Canadian legislation recognized employee – established pension plans to which employers could also contribute. In the early 20th century, these PAYG pension plans were starting to be replaced with pre-funded plans – first, funded with government annuities, then with group annuity contracts, and later with segregated fund and deposit administration contracts established by insurance companies. Today, most large pension plans (covering 85 percent of pension plan members) are funded by employer and employee contributions under trusteed arrangements with assets held and invested by trustees and/or investment managers.

There are almost 1,600 plans registered in British Columbia and Alberta, and hundreds more registered elsewhere that have members in the two provinces. Altogether they cover approximately 22 percent of British Columbia and 23 percent Albertans working in the private sector. Another eight percent of British Columbians and ten percent of Albertans are covered by public sector occupational pension plans. (See Section 2.1.4 below for more detail on the number and types of occupational pension plans in British Columbia and Alberta.)

Overall, about one third of Alberta and British Columbia workers belong to workplace pension plans. All RPPs receive favourable income tax treatment: contributions are deductible from income, and investment income accumulates tax-free. Only income received from pensions in taxed. In addition to registered occupational plans, there are a

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[5] "Pay-as-you-go" pension programs (PAYG) are pension programs that are not pre-funded – meaning that the benefits for one generation are paid largely from the contributions of the next generation. PAYG programs made sense under the economic, financial and demographic circumstances of the early to mid-1960s, when the Canada Pension Plan was first established – a time when wages and labour-force participation were growing rapidly and rates of return on investments were relatively low. The PAYG approach allowed for affordable contribution levels even while beginning to pay full retirement benefits as early as the mid-1970s, an important feature, as many of the seniors who received benefits at that time had been unable to accumulate sufficient retirement savings.

[6] 23rd Actuarial Report of the Canada Pension Plan – Office of the Chief Actuary – Office of the Superintendent of Financial Institutions Canada – Minister of Public Works and Government Services – ISBN 978-0-662-46898-1.

variety of unregistered pension arrangements in Canada. For example, because registered pension plans are subject to income tax limits designed to restrict the benefits or contributions that may be funded on a tax assisted basis, RPPs often do not provide proportionate income replacement for higher income employees. Supplementary employee retirement plans are commonly used to enhance the benefits provided under RPPs.

Pillar 3

As suggested above, those who are covered by occupational pension plans will often need or want to supplement their retirement income with additional personal savings. Governments also provide tax incentives from personal savings in RRSPs and the new Tax Free Saving Accounts (TFSAs). Those who are not covered by employer-sponsored plans must rely solely on personal savings to supplement retirement income from government programs. According to Statistics Canada, the personal savings rate has been in general decline since 1982, and as of 2007, the rate stood at only 2.6 percent.

A recent report estimated that Canadians are currently on track to replace only 50 percent of their pre-retirement income once they retire. British Columbia and Alberta results were the lowest in the country, at 47 percent and 45 percent respectively. A growing proportion of Canadians expect to fund their retirements by selling their family home, receiving inheritances and/or working. One in five Canadian working households, and 10 percent of those whose head is age 55 or over, have no retirement savings.[7]

2.1.2 Demographic environment

The impact of Canadian population demographics on pension plans is no secret. As in the rest of the Western world, Canadian pensioners are experiencing improved longevity. The ageing of the work force, driven by the progression of the “boomer” generation towards retirement, has obvious impacts, including the increasing difficulty of hiring new employees to replace older workers and the consequent impact on membership populations. Less obvious but no less important are the effects on the productivity of the workforce and the overall economy, and the consequent impact on capital market returns.

Trends in retirement age are linked to these labour market and general demographic trends. If a pensioner is going to live longer, one way of mitigating the financial impact is to retire later. If it is difficult to hire new workers, one way of mitigating this is to keep the older workers working longer. The long-term trend has been toward earlier retirement; however, recent data indicate this may have leveled off, perhaps foreshadowing a reversal in this trend.

[7] The Changing State of Retirement in Canada – Solutions for New Times – 2007 FMR LLC (Fidelity Investments Canada ULC). The Canadian 50% rate compares to 58% in the US, 56% in Germany, 50% in the UK and 47% in Japan.

To develop a picture of the overall well-being of current seniors, as well as the prognosis for the future, it is also useful to look at family asset, debt and net worth statistics. The assets include pension entitlements from workplace pension plans. The net worth picture has positive and negative aspects. On one hand, median family assets and net worth both increased by more than 20 percent between 1999 and 2005 in constant dollars (although the increases were concentrated among the wealthier families). On the other hand, debt load also increased – the total indebtedness as well as the numbers of families holding debt and the median debt per family. Most of the changes were attributable to increases in real estate values and the associated mortgage debt, but families were also carrying more debt in other forms. Even people at or approaching retirement are increasingly carrying debt. Between 1999 and 2005, the proportion of Canadians over age 45 carrying debt increased for all ages and all categories of debt. In the 55 - 64 age group, over two-thirds are still carrying debt, and after age 65, over one-third. Both these numbers had increased six percentage points from 1999.[8]

The proportion of family units with assets in RPPs or other registered savings improved only among families headed by persons 55 and over, while the younger age groups all suffered declines.

2.1.3 Financial environment

Maturing pension plans result in pension funds becoming much larger relative to the operating assets of sponsors, attracting greater attention from chief financial officers. As a result, more consideration is being given to different asset allocations and the asset/liability mismatch. We are generally seeing fewer pension plans of all types, conversions of existing plans from defined benefit (DB) to defined contribution (DC) and a tendency toward minimum funding approaches.

Risks associated with economic volatility on the markets directly affect pension plans and must be factored into estimates and projections for different plan types. Recent events on the global markets, for instance, demonstrate how sensitive pension plan valuations can be in an unstable market environment. On the other hand, pension plans are long-term investors, and if properly managed, should be positioned to withstand short term volatility.

Evolving views of how actuarial assumptions should be set (in particular, whether or not superior returns anticipated from higher-risk equity investments can be reflected in advance), and new accounting rules, have also affected the estimation and reporting of pension costs. The overall effect is an increased emphasis on containing pension cost escalation and volatility.

From a broader financial perspective, many economists believe, as the former Governor of the Bank of Canada, David Dodge, has said, that "a well-functioning pension system is an

[8] Survey of Financial Security, 2005, Statistics Canada.

important source of the long-term risk capital that is essential to finance growth."[9] It is clear that pension plans affect not only members and employers but also the broader Canadian economy.

2.1.4 Pension plans in Alberta and British Columbia

Employment pension plans covering Alberta and British Columbia employees are regulated by the EPPA and the PBSA respectively. The *Pension Benefits Act*, predecessor to the EPPA, came into effect in 1967 (succeeded by the EPPA in 1987); the PBSA came into force in 1993 and was largely modeled on the EPPA. Both statutes protect plan members by setting minimum standards for eligibility, vesting, portability, survivor benefits, employer contributions and disclosure to members, and also protect the financial health of pension plans through investment rules and funding standards.

A pension plan must be registered in the province where the plurality of members of that plan work. Pension plans for employees of federally-regulated companies in banking, telecommunications, shipping and interprovincial transportation industries are registered under the federal *Pension Benefits Standards Act, 1985*. Alberta is responsible for regulating approximately 800 pension plans with assets of more than $26.2 billion, providing benefits for more than 344,000 active and former members. British Columbia regulates about 800 plans, with assets of approximately $30 billion and 513,000 active and former members. Approximately 150 of Alberta registered plans, and 180 British Columbia registered plans have members from both provinces.

The EPPA does not govern most Alberta public sector plans, and therefore the Alberta numbers do not include those Alberta public sector plans that are not subject to the EPPA. In British Columbia, the four public sector plans are included in the above figures as they are subject to the PBSA.

RPPs in Alberta and British Columbia include:

- DB plans – that promise a specific monthly income at retirement based on factors such as earnings and years worked
- DC plans – where contributions by the employer and (usually) the employee are put aside each year. There is no promise of a specified monthly income
- hybrid plans – offering both DB and DC benefits

Approximately 106,700 Albertans and 76,750 British Columbians are members of pension plans registered in other provinces. These employees are also protected by the EPPA and the PBSA respectively.

[9] Remarks to the Conference Board of Canada – 2007 Pensions Summit, Toronto, Ontario – May 2007.

2.1.5 Pension standards legislation: past, present and future

At its inception, pension standards legislation came from an employment standards perspective and, as is common with legislation, it was a response to the "sins of the past" – financial disasters and unfair situations that had arisen in years gone by.

As a result, pension legislation originally had two main purposes and a supporting one:

- benefits standards, covering eligibility, vesting and portability
- financial standards, including pre-funding of benefits, separation of plan assets from employer assets, and investment rules – particularly rules about non-arm's length transactions and portfolio diversification
- disclosure and accountability to members, and to governments who regulate pensions

Today, while the "employment standards" features of pension legislation are still important and relevant, the emphasis has shifted toward the "financial promise" aspect of the standards. Eligibility, vesting, portability and disclosure standards are of little use if the assets to back the promises are insufficient. This is true to a greater extent for DB plans, but segregation of assets from the employer's assets, and investment in an appropriate portfolio, are also important for DC plans. It could be argued that financial issues have acquired greater importance simply because of the maturing of the system. The larger the value of the promise and the closer the member is to retirement, the more the member is apt to be concerned, regardless of whether the plan is DB or DC.

Benefits standards made pension plans fairer to workers in some respects and resulted in the provision of more benefits to more members and beneficiaries, but also made them more costly and difficult to administer. Increasingly, since workplace pensions are optional, the social policy issue for pensions has expanded from ensuring that workers in pension plans are treated fairly toward trying to halt, or even reverse, the slide in coverage.

While many employers who sponsor pension plans still consider their plans to be important tools for attracting and retaining employees, some perspectives are changing with respect to pensions and retirement. With current and anticipated labour shortages, some employers would like to shift emphasis to retaining older workers in the labour force and removing what they consider to be outdated incentives to retire. Pension plan members, on the other hand, continue to view early retirement opportunities as valuable employment benefits, and would be reluctant to lose them.

2.1.6 Obstacles to establishing and maintaining pension plans

As indicated above, it is becoming increasingly likely that a private sector employee will not have a pension plan. The reasons most frequently cited include:

- Competitive pressures domestically and internationally have made companies unwilling to take on the risk of funding DB plans or, in some cases, even the more controllable costs of DC plans.
- DB costs have increased in recent years, and many employers' contributions have increased dramatically, often due to special payments for solvency deficiencies. In some cases, cost increases were partly the result of income tax rules requiring employers to take contribution holidays to maintain their DB assets below statutory limits.
- Volatility in interest rates and investment returns results in unpredictable DB funding requirements.
- Potential future liability for unsatisfactory investment outcomes, especially in employee-choice plans, has made sponsoring DC plans unattractive to some employers.
- Pension plans can be costly and difficult to administer for employers with employees in more than one jurisdiction, due to the often divergent pension standards across Canadian jurisdictions.
- Court decisions pertaining to pension plans, and new accounting requirements for DB arrangements, have added to the challenges of sponsoring a plan.
- Small and even mid-size employers often find it financially and administratively difficult to sponsor a pension plan for their employees.

The time has come to review the pension regulatory system from first principles, while recognizing that there is a mature system in place that needs to be maintained. It is necessary to determine what is needed to relieve short-term problems without jeopardizing the long-term health of the system.

2.2 General public policy issues overview

In today's demographic environment, with the leading edge of the baby boom generation now entering their retirement years, public policy discussions are turning to the health and security of our aging population and the importance of pension plans.

While governments and businesses struggle with the prospects of what some are calling a looming labour shortage, there is mounting concern that those reaching retirement age may not have enough to live on. Many are concerned about what retirement may look like for near-retirees[10] and what the future may hold for their children and grandchildren when they wish to retire.

[10] Near-retirees are defined as non-retired Canadians aged 45 to 59 – *2007 General Social Survey Report – The retirement plans and expectations of older workers* – 2008 – Statistics Canada – Catalogue No. 11-008.

The three pillars of pension plans, once a convenient way to catalogue different sources of retirement income, have become both more meaningful and more controversial as we consider these questions. What combination of the three will provide the right balance in retirement? Are there more pillars? How much do we need to save before we can consider retiring? Should re-entering the workforce after retirement or savings invested in the family home be considered a fourth pillar? Do pension plans play a greater role in our economy than they once did? What would the impacts on our economy and capital markets be if the occurrence and character of pension plans were to dramatically change?

2.2.1 Role of pension plans in the retirement income system

Components of retirement income

Within the three pillars of retirement income described above in Section 2.1.1, there are a number of revenue sources – and a variety of views on how these sources fit into the pillars. Regardless of which pillar they may belong to, the following are all potential components of retirement income:

- government-sponsored, PAYG, social security programs (e.g. OAS and GIS)
- government-sponsored, funded or partially funded, contributory pension programs (e.g. CPP)
- employer-sponsored occupational pension plans
- individual pension plans
- RRSPs
- profit-sharing plans
- other savings plans
- other personal savings (e.g. the new TFSAs)
- investment income
- home ownership
- family support[11]
- post-retirement employment

Any additional income in retirement above the 40 percent of pre-retirement income – up to a limit of the national average wage – that CPP and OAS will provide, must come from occupational pension plans, personal savings or other sources. Replacement of income in

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[11] "Each of the four pillars of retirement income (*government, employer, family and self*) is regarded by Canadian respondents as making a contribution, with both *self* and *government* seen as more important contributors than *family* and *employers*." *The Future of Retirement – Investing in Later Life* – "Future of Retirement" survey (Sept 2008) – HSBC Insurance.

excess of the national average wage must also be funded outside of government social security and pension programs.

How much is adequate?

It is generally accepted that income requirements are reduced in retirement because work-related expenses, such as travel, restaurant meals and business clothing are no longer a factor, house mortgages are expected to be paid off and children's educations completed.

While conventional financial thinking has been that an acceptable standard of living in retirement requires some 60 - 70 percent of after-tax pre-retirement income, the ratio of retirement income to pre-retirement income (the "replacement ratio") that is required to provide an adequate standard of living is not uncontroversial. Some have suggested that a number of new factors in today's environment have increased the recommended replacement ratio. Factors that may contribute to higher replacement ratio requirements include:

- increased life expectancies
- more active senior years
- higher debt loads carried by retirees
- health care and supported living expenditures in later years of retirement

It has been suggested by some that "the new 60 - 70 percent" may be something in the range of 75 - 85 percent,[12] although one recent study went so far as to predict that post-retirement income requirements will rise to an average of 126 percent of final pay at retirement after factoring in inflation and increases in medical costs.[13]

While increased health care costs are a likely reality with increasing life expectancies, these projections may also be too simplistic, or simply out of context. For example, the 126 percent projection reflects the cost of health care in the United States for individuals who are not insured through their employment. Although increasing health care costs cannot be ignored, this pressure is mitigated in Canada because of its universal health care system. Anecdotal experience also suggests that increases in health care costs may be offset by corresponding decreases in travel and other recreational activities that cannot be enjoyed in poor health.

[12] The Changing State of Retirement in Canada – Solutions for New Times – 2007 FMR LLC.

[13] July 7 news email – Hewitt – "*Total Retirement Income at Large Companies: The Real Deal*," July 2007 – Hewitt predicts that workers will need to replace, on average, 126% of their final pay at retirement, when factoring in inflation and increases in medical costs. In other words, assuming inflation of 3% and a retirement age of 65, an average 40-year-old with 10 years of service and earning US$83,000 at retirement in today's dollars would have saved enough to provide just $70,500 per year in retirement in today's dollars – a $34,000 shortfall. Two-thirds of employees are expected to have less than 80% of their projected income needs at retirement.

Ultimately, estimating retirement income adequacy is subjective, and depends very much on the particular circumstances of the individual or family under consideration. The actual replacement ratio required will depend on a number of specifics, not the least of which is the base level of income before retirement. For those at the lowest pre-retirement income ranges (up to approximately $20,000), the required replacement ratio is likely 100 percent – which would generally be covered by government-sponsored social security and pension programs. At the opposite end of the spectrum, those with the highest incomes likely require a very small replacement ratio to support a reasonably comfortable living standard.

Although retirement replacement ratios are generally articulated in terms of income comparisons (post-retirement as compared to pre-retirement), the better base may be pre-retirement *spending* (post-retirement income as compared to pre-retirement spending). This correctly eliminates savings from the equation – as savings, like work expenses, are not a factor in estimating an adequate retirement income. In other words, an individual who earns an annual income of $200,000 before retirement, but saves half of it, should need no more in retirement than a comparable individual who earns only $100,000 and spends it all.

According to Statistics Canada, research has shown that while the Canadian pension system is relatively effective in helping seniors to stay out of poverty, the extent to which it sustains a comfortable living standard continues to be the subject of considerable analysis. Current studies indicate that for those with average incomes, family income tends to decline from age 60 to 68, and stabilizes at approximately 80 percent of the income level enjoyed at age 55. Low-income individuals experience little change in income as they move from age 55 through the retirement years, largely because of the income maintenance effects of the public pension system. While they may experience significant income instability in their late 50s and early 60s, their income tends to stabilize after retirement. Higher-income individuals experience substantially larger income declines in retirement, with the result that income disparities between similar age groups are significantly reduced in retirement years.

Recent trends show that retirees are experiencing higher income levels than in the past, largely because of higher private pensions. However, replacement rates have changed little among income groups, and whether recent gains in income levels will persist in future is uncertain with pension coverage falling among younger workers.[14]

Sources of retirement income – what should they be?

It is generally agreed that all three pillars are necessary to sustain a stable, adequate living standard in retirement. Private pension plans for employees are encouraged by government because of their role in supporting the social policy objective of an independent, healthy population of seniors. While taxpayer-supported government programs are designed to provide a reasonable minimum income, most retirees seek more

[14] Statistics Canada March 2008 – Sebastien Larochelle-Cote, John F. Myles, Garnett Picot.

than the minimum. Occupational pension plans may reduce the need for government-sponsored income security benefits.

According to Statistics Canada, the average Canadian over 65 obtains 47 percent of his or her income from a combination of OAS and CPP, 29 percent from pension plans and RRSP savings converted to registered retirement income funds and the rest (24 percent) from other investments, other government programs or employment. Clearly the 29 percent portion provided by pension plans and RRSPs is significant – it can be the difference between a subsistence level and adequate replacement of pre-retirement income.[15]

Unfortunately, the third pillar is weakening. Only 34 percent of British Columbians and 33 percent of Albertans[16] are covered by employer-sponsored pension plans. Eliminating public sector pension plan coverage, only 22 percent of British Columbians and 23 percent of Albertans employed in the private sector are covered by pension plans. These are among the lowest participation rates in Canada. Coverage has been in general decline across Canada for at least a decade – peaking at 45 percent nationally in 1991, and dipping to less than 39 percent by 2006.

Furthermore, the value of pensions provided is eroding. As noted in a recent news release on the elimination of automatic full indexing in the Ontario Teachers Pension Plan[17]:

> Defined-benefit pension plans with fully indexed funds are becoming an endangered species. At one time, more than 70 percent of all companies supported such plans, but increasingly, private companies have moved toward defined-contribution plans that do not offer guaranteed benefits. "We are calling this the shifting burden," said Randy Ambrosie, president of AGF Funds Inc. "Individual Canadians are now left with the responsibility of managing their retirements … and that has created an uncertainty."

2.2.2 Financial literacy - another pillar?

If individuals face an increasing burden to save for their own retirements, are they equipped to do so?

According to a recent national survey,[18] 53 percent of Canadians believe they should be better able to manage their finances, and two-thirds of young families believe they should have a better understanding of their personal finances. The survey showed that 43 percent of Canadians are concerned about not having enough money to retire comfortably. Other concerns included:

- spending beyond their means (20 percent)
- worry they will outlive their money (12 percent)

[15] Canada's Retirement Income Programs: A Statistical Overview (1990-2000) Statistics Canada 2003.
[16] Pension Plans in Canada, Statistics Canada, January 2006.
[17] *Teachers alters index formula* – Byline:Karen Mazurkewich – National Post October 2, 2008.
[18] The Harris/Decima poll, commissioned by BMO Financial Group, was conducted from June 17 to 25, 2008 and based on a randomly selected sample of 1,000 Canadian adults.

Of perhaps greater concern, 51 percent of poll respondents said that financial institutions make money matters more complicated.

Being "financially literate" is understood to mean having the general information and knowledge required to participate in society as an informed and responsible consumer. It means knowing how to track income and expenses – and how they relate to one another, understanding what compound interest is and how it is calculated, knowing how to use the banking system and other financial services, being familiar with tax incentives to save – such as RRSPs and TFSAs and how they work, understanding the relationship between credit and debt, being aware of the basic differences between types of investments and the risks associated with them, and much more. Being literate on financial matters provides the foundation for saving and investing wisely, which in turn supports the accumulation of assets as both a source of future income and a safety net when unexpected pressures arise. Financial literacy, like reading, writing and arithmetic, is fundamental to making appropriate judgments about every-day issues such as home ownership, skills training, children's education, personal savings and retirement.

In Canada, the 2007 federal budget called for Canadians to have the information they need to make sound financial decisions. It emphasized the need in particular for young Canadians to become more financially fluent in order to understand important concepts such as the relationship between risk and reward. It also called for less fine print and more plain-language disclosure from financial institutions. Three million dollars was earmarked in that budget over a two-year period to develop instructional materials for financial literacy, and to facilitate sharing of information and instructional materials among financial educators.

2.2.3 Impact of pension plans on capital markets

Employment pension funds have accumulated large amounts of assets over the years, becoming significant players in international capital markets. With populations ageing and waning reliance on PAYG, unfunded public pensions, the size of pension funds is expected to increase even further in the future. In 1998, private pension fund assets were 48 percent of gross domestic product (GDP) in Canada. This compared to 86 percent in the United States and the Netherlands, and 84 percent in the UK. In 2000, international pension fund assets comprised anywhere from 5 percent (France, Spain) to 128 percent (Sweden) of GDP. In the Netherlands, after pension reform initiatives, the percentage is expected to grow from 110 percent in 2000 to 195 percent in 2040.[19]

With 13,800 RPPs in place in Canada, and the considerable growth in institutional investments, Canada's pension plans are a significant factor in the capital markets. According to the OECD, Canadian pension plans increased their share of total institutional

[19] Government of the Netherlands – Ministry of Social Affairs and Employment website – http://internationalezaken.szw.nl 2007.

investments more than 8-fold between 1980 and 2000.[20] As noted by David Dodge, the former Governor of the Bank of Canada, pension plans, and especially DB pension plans, generate important benefits to economic efficiency. They transfer risk from individuals to collectives, and with their generally sophisticated asset managers, more efficiently allocate personal savings by investing pools of contributions across appropriately varied asset classes over very long time horizons. In doing so, they can finance large investment projects at competitive rates of return, effectively transferring risk from individuals to those investors that are best able to bear it.[21]

As of 2007, it was estimated that total assets held by the Canadian pension system were about $921.1 billion, including $122.7 billion for the CPP and $34.7 billion for the QPP which, together, form one of the largest pools of investment capital in Canada.[22]

In his December 2006 speech to the Economic Club of Toronto, Mr. Dodge noted his concern that the current regulatory framework in Canada contains disincentives for employers to establish and maintain pension plans:[23]

> Pension regulation is another important issue for the efficiency of Canada's capital markets. There is a crucial need for a framework that provides the appropriate incentives for employers to establish and maintain pension plans, so that the vast pools of capital in these plans can make their maximum contribution to the efficiency of the Canadian economy.
>
> But our current regulatory framework instead provides a number of disincentives for firms to establish or maintain defined-benefit pension plans. These disincentives, along with recent low long-term interest rates, have led to increased solvency deficits among many defined-benefit plans.

Mr. Dodge emphasized the long-term perspective of DB pension plans and its fit with the need for significant infrastructure investments in Canada. He recommended that governments remove disincentives to establishing and maintaining DB plans and establish an appropriate framework for using public-private partnerships to promote private investment in public infrastructure.

DB pension plans have been cited as having a number of unique and significant advantages. They allow members to automatically pool risks, such as longevity risk and retirement date-sensitivity, by virtue of their design. They give employers a mechanism for adding a long-term element to the employment contract. They provide the financial system with a vehicle that is well equipped to take on long-term risk, thereby contributing to capital market efficiency.

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[20] Capital Markets and Sustainability: Investing in a Sustainable Future – 2007 – ISBN 978-1-894737-13-5.
[21] Remarks by David Dodge, Governor of the Bank of Canada, to the Association des MBA du Québec Montreal, Quebec – November 2005.
[22] *Preliminary results of the Pension Satellite Account, 1990 – 2007* – Statistics Canada.
[23] Remarks by David Dodge, Governor of the Bank of Canada, to the Economic Club of Toronto – Toronto, Ontario, December 2006.

While the strong capital markets of the 1990s attracted considerable pension fund investment, sharp declines in stock markets worldwide since 2000 have contributed to eroding funding ratios, causing companies to raise contributions, renegotiate pension plans and amend investment policies. With significant losses in the equity markets, combined with changes in accounting rules requiring full disclosure of pension liabilities and regulatory action by governments imposing additional reserve requirements for equity risk, firms are moving significant investments into fixed income markets. For example, General Motors, the largest DB sponsor in the US, recently announced that it had moved 20 percent of its $101 billion pension portfolio into global bonds. In the Netherlands, the largest DB pension market in continental Europe, the new 105 percent funding ratio requirement along with the obligation to mark-to-market pension liabilities, has resulted in a major shift to longer-duration bonds and derivatives.[24]

While pension plans with their vast pools of capital can contribute to the efficiencies of the capital markets, they are also impacted greatly by the risks and volatility on those markets. The complex interactions between pensions and capital markets are important factors for consideration in developing pension policy for the future.

[24] The Coming Shakeout in the Defined Benefit Market – McKinsey and Company.

3.0 Guiding Principles and Objectives

The recommendations presented in this report are a culmination of the combined knowledge and experience of the Panel members as informed by our research and all of the valuable input we have received from stakeholders and other experts over this past year. Sorting though this considerable volume of information and spectrum of views to reach consensus on so many different issues required that we take a philosophical approach – establishing a set of overarching principles to guide us in finding a balance – crafting a package of recommendations that when viewed as a whole is fair, practical and affordable to all participants in the system. These principles were developed based on our views of the objectives of the pension system, and the purposes of regulating it.

Some principles and objectives are inherently at odds with others – fully meeting one might mean violating another. Recognizing this, the Panel weighed possible options against sometimes competing principles and objectives based on experience, research and stakeholder input in an attempt to arrive at a balanced solution. The Panel believes that the risks associated with subjectivity were mitigated by the variety of views and backgrounds on the Panel itself.

3.1 Guiding principles

The following value statements about the pension system and related standards are the overarching principles the Panel employed to guide them in developing the recommendations in this report:

- Occupational pension plans are an important component of the Canadian retirement income system.
- Pension standards legislation should encourage, not discourage the establishment and maintenance of pension plans.
- Occupational pension plans should be a voluntary component of the retirement income system.
- Occupational pension plans are best characterized as contracts between employers and employees.
- Pension funds must be held separately from the assets of the parties to the arrangement.
- Pension plan trustees and administrators occupy a fiduciary role with respect to plan members.
- There must be clear allocation of roles and responsibilities for governing a pension plan.

- Regulation to protect the interests of plan members should be proportionate and appropriate to the problem it addresses.
- Equitable treatment of groups of plan members should be encouraged where feasible.

3.2 Objectives of pension standards legislation

As noted above, the Guiding Principles were developed based on the Panel's views of the objectives of the pension system. The Panel believes that pension standards legislation should:

- promote improved retirement incomes for private sector workers in Alberta and British Columbia by facilitating coverage of workers in occupational pension plans;
- not damage the competitiveness of the economies of Alberta and British Columbia by inappropriate, unjustifiable or overly complex regulation of the pension system;
- be harmonized between the provinces;
- provide the flexibility to design attractive, affordable pension plans that meet predetermined objectives;
- balance the security of benefits with predictability of plan costs;
- ensure that all parties have a clear understanding of "the pension deal" under different plan types – the entitlements, roles and responsibilities of all parties;
- ensure that all parties to a pension plan have full and open access to information about the plan, as appropriate to their role or stake;
- not inhibit worker mobility;
- enhance the security of the pension promise;
- be enforceable, practical and affordable;
- focus on outcomes; and
- intervene in private decisions only to the extent necessary to protect plan beneficiaries' interests.

4.0 What We Heard

In our discussion paper *A New Pension System for the Future: Finding a Balance* we asked submitters to consider 39 questions that were meant to elicit views on a wide variety of pension policy issues. We were very pleased to have received so many submissions, and were impressed with the careful thought and intelligence with which they were handled. We received 118 submissions, many of which provided comprehensive sets of recommendations. Others commented on only one topic, or on a few issues that were of particular concern to them (58 submissions). A number of submissions were also made in support of comprehensive submissions made by others (13 submissions). While some followed the format of the discussion paper questions, many responded in their own format, not necessarily responding to the specific questions posed. The following is a summary of what we heard, which topics generated significant agreement, and which ones were the most contentious.

Objectives of the legislation

- Comments on the appropriate objectives of pension standards legislation overwhelmingly favoured the objective of increasing coverage, with some specific emphasis on the promotion and growth of large DB plans.
- Nine submitters suggested that the overall objective of pension standards legislation should be to increase occupational pension coverage in general, although several noted that this objective must be balanced with that of encouraging employers to establish and maintain plans. Another five noted that the objective should be to simplify standards to encourage coverage. One submitter said that the focus of the legislation should be to protect member benefits.
- Other ideas included increased certainty for plan sponsors, ensuring that the pension promise is understood, and minimizing cost and bureaucracy. One submission noted that the objective of standards for negotiated cost DB plans, in particular, should be fairness of benefits and equity among members, rather than benefit security for any particular member.

Mandatory or voluntary system

- Submitters were split on the issue of whether employers should be required to have occupational pension plans. Seventeen submitters commented on the question of whether occupational pension plans should be mandatory for employers. Of these, nine supported continuing with a voluntary system, citing a potential undue burden on smaller employers if they were required to sponsor a pension plan. Those that supported a mandatory system felt that this would be the most effective way to expand pension coverage. One submitter said that a mandatory system should be considered only if an incentive-based system proves to be unsuccessful.

- Most of those that supported the continuation of a voluntary system recommended that there be more incentives for employers to establish and maintain pension plans, and several suggested that simplifying the rules could be one very effective incentive. One submitter suggested the opposite approach: disincentives, such as increased taxes, on those employers that don't provide a pension plan, as an alternative to mandatory coverage.

Financial literacy

- Thirteen submitters addressed the question of financial literacy, including ten who recommended that financial education should be part of the public school curriculum. Other suggestions included a government-initiated financial literacy campaign, and incentives to encourage employers to provide financial education to their employees.

"One size does not fit all"

- Submissions were consistent in their support for applying different rules to different types of plans.
- Nineteen submitters recommended different rules depending on the nature of the "pension promise" – for example, DB plans that guarantee a fixed benefit amount and vary contribution rates to achieve this (traditional DB arrangements) should be subject to different rules than plans with fixed contribution rates that target a certain level of benefit but may reduce benefits if necessary (multi-employer negotiated cost target benefit plans), or plans that promise only a fixed contribution rate with a variable benefit (DC or money-purchase plans).
- Eleven submitters also suggested that innovation in plan design should be encouraged, and that the rules should be flexible enough to accommodate new plan models.

A more principles-based statutory framework

- The submissions reveal a broad-based support for incorporating more principles into pension standards legislation. While five submitters offered unqualified support for a principles-based approach in order to provide the flexibility required to acknowledge the changing reality of pension plans and business generally, the majority of stakeholders that commented on this (17 submitters) supported combining principles with rules. One submitter suggested how to structure a combination of principles and rules, recommending that the overall guiding principles be legislated, with more specific supporting rules set out in the regulations (or in regulatory policies) where it would be less complicated to change specifics to reflect changing economic realities.

- Among those supporting a mix, opinions differed as to the appropriate balance between principles and rules. Standards for which it was suggested that rules should be retained included minimum funding standards, disclosure requirements, vesting and locking-in, and minimum benefit provisions. There was a general consensus that the prescriptive investment rules found in Schedule III to the federal *Pension Benefits Standards Regulation* (Schedule III) and adopted by most of the provinces should be replaced with the "prudent person" principle. Some submitters suggested principles be used to address surplus ownership, plan design and funding.

- Three submitters were opposed to any movement to a more principles-based system. They expressed concern that principles would not provide adequate guidance for regulators or pension plans, resulting in lower standards and increased litigation – or that it would amount to the deregulation of pensions.

Financing the regulatory system

- Twelve submitters commented on the question of how the regulatory system should be financed. Eight supported a user-pay approach, under which regulated pension plans would pay for all of the costs of regulation, while four said that pension regulation contributes to broader public policy goals that should be paid for by the general taxpayer population.

- Several submitters that supported user-pay did so under certain conditions:
  - the regulator be held accountable for the expenditure of fees paid by pension plans
  - other non-pension related operations not be subsidized with pension user fees
  - regulatory costs be minimized by simplifying the legislation and avoiding overregulation.

Interprovincial and national harmonization

- A significant number of submitters commented on the issue of harmonization (30 submitters). They considered the prospects of interprovincial and/or national harmonization of all standards, and also identified specific standards in need of harmonization between the two provinces.

- There was considerable support for harmonizing pension standards in the two provinces (15 submitters), as well as harmonizing pension standards across Canada (21 submitters). One submission suggested that harmonizing British Columbia, Alberta and Ontario pension standards may be a more feasible option than attempting to reach consensus across the country. Two submitters thought that harmonization was not in the best interests of pension plan members due to the risk that it could result in weaker standards.

- Specific topic areas suggested to be in need of harmonization included:

- rules for individual pension plans
- actuarial filing dates
- disclosure requirements
- contributions deadline in valuation year
- regulator guidelines
- rules for life income funds
- superintendent authority to designate class of employees on plan merger or acquisition

Funding standards

- Twenty-three submitters recommended the elimination or increase of income tax limits on contributions and the amount of surplus that may be held in a pension plan, suggesting that the limits prevent plan sponsors from funding plans in a prudent manner. Submitters commenting on this issue were unanimous in their view that sponsors should not be prevented from building adequate margins to protect their plans from the volatility that can result from changes in economic factors such as interest rates, inflation and equity returns.
- Submitters' views varied on the types of funding tests that should apply. Eleven submitters expressed the view that both solvency and going-concern tests should continue to apply, with three of these recommending that the focus for DB plans be on solvency.
- Twenty-three submissions recommended that multi-employer negotiated cost target benefit plans should not be required to fund for solvency, suggesting that these rules are inappropriate for this type of plan because of the target nature of the benefit and/or the low likelihood that this type of plan would be wound up.
- Eleven submissions suggested that the health of the sponsor should be taken into account in establishing the appropriate level of funding. They suggested that a financially sound sponsor reduces the risk to the pension fund, thereby reducing the margins that should be required for such plans. Seven submitters opposed taking the financial health of the sponsor into account, expressing some concern as to how the financial health of the sponsor would be measured for this purpose.
- Ten submitters suggested that the level of matching between assets and liabilities in the pension fund should be taken into account in the funding rules, while five said that the risk profile of the pension plan should not affect the funding requirements.
- Five submitters specifically suggested a requirement for provisions for adverse deviation (PfADs) and/or target solvency margins. Four were opposed to this approach.

Ownership and use of surplus

- Issues related to the ownership and use of surplus in traditional DB plans are key to many stakeholders. Recommended solutions were somewhat predictable based on the particular role each commentator plays in the pension system. The majority of those that commented on this issue (29 submitters) recommended that surplus ownership be aligned with funding risk (13 submitters), but the question of who actually bears the risk in various pension arrangements remains contentious.
- In order to resolve the legacy issues related to surplus ownership, seven submitters suggested that the legislation explicitly provide that contract law, rather than trust principles, apply to pension funds, and six (including some of the former group) recommended explicitly overriding common law on an issue-by-issue basis, e.g. asset transfers, contribution holidays, surplus withdrawal, and plan expenses. Two stakeholders suggested establishing a new set of "business trust rules" that would apply to pension trusts. The majority of submitters recommending an override of trust law felt that a retroactive override would be the only way to truly resolve the legacy issues, but also recognized that a prospective override may be less controversial.
- Two submissions suggested that the issue of surplus ownership be resolved by requiring plan sponsors to reach an agreement with members, through arbitration if necessary.
- Three submitters said that the employees own the surplus and they would strongly object to any change that would undermine their right to it. They called for more restrictions on the ability of sponsors to access or withdraw surplus in an ongoing plan.
- One submitter suggested that legacy issues have been satisfactorily dealt with by the courts and no statutory override is necessary. Two thought that the legislation should, at a minimum, deal with less contentious legacy issues such as contribution holidays and plan expenses. Two recommended that employers be permitted to withdraw surplus from an ongoing plan without the requirement to obtain member consent.

Pension solvency funds

- The concept of a separate account from which plan sponsors could withdraw surplus without member agreement drew a broad spectrum of support (14 submitters), although details on how these vehicles would work were somewhat vague.

Letters of credit

- There was significant support for the use of letters of credit to fund solvency deficiencies, with 18 submitters in favour of allowing them on a permanent basis.

One of these also recommended allowing letters of credit to fund going-concern liabilities. One submitter suggested that letters of credit be allowed for additional reserves once the plan is fully solvent, and one recommended that third-party risk insurance and other covenants providing benefit security be allowed in addition to letters of credit.

Investment rules – Schedule III quantitative limits

- Submitters commenting on this topic (14) were consistent in their recommendations that the quantitative limits be eliminated and the prudent person principle adopted as the standard for investment decisions. Some submitters said that the Schedule III rules regarding conflict of interest and related party transactions should be retained by incorporating them into our pension standards statutes.

Environmental, social and governance (ESG) considerations

- Eleven submitters addressed the question of ESG. Eight recommended that consideration of ESG factors be allowed in making investment decisions but not required, one supported requiring ESG factors to be considered and one suggested that the legislation clarify whether ESG is allowed and under what conditions. One submitter suggested that ESG be allowed only if there is consensus among plan members.

Governance standards

- On the question of whether governments should set standards for good governance, a significant number of submitters preferred principles-based "best practices" guidelines to legislated standards. Of 15 submitters that supported this approach, four specifically suggested that the Canadian Association of Pension Supervisory Authorities' *Guideline No. 4: Pension Plan Governance Guidelines and Self Assessment Questionnaire* (CAPSA Guidelines) be adopted for this purpose.
- Five submitters recommended legislating governance standards, including one stakeholder that specifically supported using the CAPSA Guidelines for this purpose. Three submitters suggested that compliance with governance standards should be assessed annually.
- Eight submitters recommended that the Capital Accumulation Plan (CAP) Guidelines issued by Canada's financial regulators be adopted as the basis for DC plan governance, including two submitters that recommended that they be incorporated into the legislation or regulations.

Fiduciary protection

- Most submitters that commented on the question of governance standards, in particular with respect to DC plans, supported the introduction of statutory protection for compliant sponsors. Seventeen submitters indicated their support for the introduction of legislated safe harbour rules for DC plan sponsors. Four were opposed to safe harbours. One stakeholder suggested that protection from liability should be available generally (not just for DC plans) to administrators that comply with and make payments in accordance with the pension statute. One suggested that there should be legislated safe harbour protection if governance standards are encoded in the statute.

Disclosure to members

- Those that commented on this topic generally emphasized the need for more disclosure, especially with respect to the financial health of the plan (eight submitters) and the plan's funding policy (four submitters). For plans designed to deliver a target benefit, such as negotiated cost multi-employer plans, there was support for ensuring that the target nature of the promise be clearly communicated (nine submitters).
- Six submitters felt that the current disclosure requirements are sufficient, although one of these limited this assessment to plans in which members participate in plan governance.

Alternatives to traditional DB plan structures

- Submitters suggested that the legislation should be flexible enough to accommodate innovations in plan design (11 submitters), and recommended some designs that should be considered:
  - industry-wide or broadly based multi-employer plans (ten submitters)
  - multi-employer or group DC plans (four submitters)
  - simplified specimen or DC plans (five submitters)
  - target benefit plans (four submitters)

Phased retirement

- Of the 20 submissions that commented on this topic, nine supported amending provincial pension legislation to facilitate phased retirement. Three of these emphasized that their support was for a permissive rather than a mandatory provision, while one supported allowing phased retirement as a default if the plan terms are silent on the matter. One submitter did not support phased retirement if it is at the employers' discretion and does not protect employees' interests.

- Three submitters said that current pension standards are adequate to facilitate phased retirement in British Columbia and Alberta. One recommended that the Alberta legislation be amended to permit concurrent accrual and payout, without having to offset the accumulated pension against the ultimate pension at full retirement.
- With respect to negotiated cost multi-employer plans specifically, two submitters suggested that these plans be allowed to suspend a pension if the member returns to employment in the same industry and region as when benefits commenced.

Unlocking

- There was considerable commentary on the question of how much, how often and under what circumstances funds should be allowed to be withdrawn from pension plans for other uses. Opinions varied on this issue, with a fundamental split between those who support minimal unlocking, believing that the integrity of the pension system and its objectives are threatened by allowing funds to be removed for other uses (ten submitters), and those who support more flexibility for those who wish to access what they argue is "their own money" (nine submitters). Some who supported more flexibility suggested that the amount that may be unlocked should be a plan design feature decided by plan administrators (three submitters).
- Three submissions emphasized the need to harmonize the unlocking provisions between the two provinces, regardless of what solution is ultimately decided upon.
- Other ideas suggested were:
  - Allow unlocking of DC accumulations at retirement (two submitters, one noting that this would be subject to spousal protection).
  - Recommend a national review of the social benefits and costs of early access to pension funds for purposes other than retirement (one submitter).

Pension benefits guarantee fund

- Although not specifically raised in our discussion paper, 11 submitters suggested that the Ontario pension benefits guarantee fund model has significant problems and should not be adopted.

5.0 Recommendations – Introduction

We have organized our recommendations into sections reflecting certain key topic areas. Each topic area is arranged around the following structure: articulation of the issues to be considered, discussion including the input from stakeholders, and finally the Panel's perspectives and recommendations on the topic at hand. A consolidated list of the recommendations contained throughout these topical sections is contained in Appendix D for ease of reference.

All of our recommendations relate either to the pension standards legislation itself, or to the administration of the regulatory system, with one important exception: Section 11, which contains a proposal for a new pension plan.

There are extensive references to stakeholders' views throughout this report. We have not attempted to indicate any specific stakeholders' views in any instance, because in many cases, more than one individual or group expressed similar views.

Our assumption underpinning all recommendations is that a complete rewrite of the two Acts, yielding one harmonized Act, will be the end result. Nonetheless, our review, as noted above, did not attempt to cover exhaustively every detail of pension law or even pension standards legislation. Consequently, our recommendations are focused on issues we regard as having the greatest importance and on solutions that can have the greatest impact. If we do not include a recommendation on any particular aspect of the standards, it should not be inferred that we either endorsed or rejected that particular element. We urge readers, including those within the two governments who may in future be assigned the task of converting some of these recommendations into law, to look carefully at the principles we have enunciated, for guidance as to how we would view any particular standard that is not otherwise specifically addressed in this report.

We have presented what we regard as a package of recommendations that represents, in our best judgment, a balanced approach to addressing the principles we have outlined in Section 3 and to the sometimes conflicting viewpoints of stakeholders. It is important that readers not view particular recommendations in isolation from all of the other recommendations contained in this report, but rather consider each as an element of an integrated whole.

Finally, the Panel's mandate extends only to pension standards legislation in Alberta and British Columbia. To the extent that our recommendations are not consistent with current or future legislation in other provinces, multi-jurisdictional plans with employees in Alberta and/or British Columbia and in other provinces may not be able to benefit fully from these recommendations or may only be able to take advantage of any resulting changes to our legislation with respect to employees in our two provinces. That said, there is also hope that the proposed CAPSA multi-lateral agreement (discussed further in Section 6.5, below) will facilitate the administration of such plans, particularly in the areas of plan governance, funding and investment. The need for greater national harmonization is pressing and we hope that the recommendations contained in this report can assist in fostering discussion between the provinces and the federal government.

6.0 Objectives and Regulatory Framework

6.1 Objectives of the legislation

Issues

The Panel has agreed that in order to develop recommendations to streamline, harmonize and modernize pension standards in Alberta and British Columbia, it is critically important to clearly establish the purposes – or objectives – of the legislation. The objectives of pension standards legislation have changed over time, with the evolution of pension theory, demographics, social priorities and the economic context. In order to determine appropriate objectives for modern pension standards legislation, there are a number of broad social and economic policy issues that must be considered, including:

- What should be the objectives of pension legislation, and how should competing objectives, including the following, be prioritized?
  - security of benefits
  - fairness to plan members
  - adequacy of benefits
  - creating a level playing field between employers
  - promoting pension plan creation and maintenance
  - transparency and disclosure (and to whom)
  - financial literacy of plan members
- What role, if any, should occupational pension plans play in the Alberta and British Columbia retirement income systems?
- 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?
- Should the goals of the legislation include promoting expansion of the system in Alberta, British Columbia and throughout Canada? If so, in what way?
- To what extent can or should the governments deal with the issue of sufficiency of retirement incomes, and how?
- What role, if any, should employers play in ensuring sufficient pension coverage and income in retirement?
- What role, if any, should occupational pension plans play in attracting and retaining the future workforce and facilitating worker mobility?

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

Discussion

Pension plans started before regulation. Pension standards legislation followed – in order to protect plan members from unfair treatment and irresponsible management by another party of that member's pension entitlement. Arguably, a key objective of pension regulation is just that: to protect pension plan members and ensure that the pension promise is kept. Why, then, are many stakeholders suggesting that the objective of the legislation should be to encourage coverage, reduce costs, not hinder investment or simplify standards?

In its broadest sense, regulation is a principle, rule or condition that governs the behaviour of citizens and organizations. Governments use regulation in combination with other instruments to achieve public policy objectives.

Regulation, and financial sector regulation in particular, is generally imposed in order to protect consumers in circumstances where they may suffer from unfair treatment – often because consumer access to information is limited due to complexity, volume and/or other factors, or because the consumer has no effective control in certain situations (pension plan members being prime examples). Financial sector regulation is often intended to address imbalances of knowledge and information between supplier and consumer. Lack of sufficient and appropriate information prevents consumers from making properly informed decisions that may seriously impact their well-being.

Historically, financial sector regulation has followed market developments or innovations that led to a perceived need for consumer protection. In the pensions context, the rapid expansion of workplace pension plans in the mid-twentieth century soon led to the development of pension regulation when it was determined that workers were unfairly losing benefits. Pension plans have been regulated because of the perceived need to protect the interests of members. While pension plans are intended to provide some level of financial security in retirement, most plan members were thought to lack sufficient power, knowledge or experience to ensure that their objectives were being met.

Whether participation is compulsory or optional, individual plan members generally have little or no opportunity for negotiation with respect to the terms of the plans. Contributions to pension plans by members or by their employers are generally made long before potential benefits are to be realized. Pension beneficiaries generally have little understanding of the complexities of their pension plans and no immediate means of ensuring they will receive value for the contributions. Even if members were able to negotiate their own pension terms, it would be challenging for most to understand, articulate and bargain in their own best interests. Furthermore, they generally lack effective control over the management of their pension funds – except in perhaps self-directed DC plans, and even in that case the member usually has no control over the menu of investment options offered. Therefore, in the interests of efficiency and fairness, governments have seen fit to intervene by setting minimum standards for the funding, administration and governance of pension plans.

However, that original legislation was premised on an assumption – that employers would voluntarily provide pensions to workers – that may no longer hold.

Stakeholder views illustrate some of the fundamental evolving principles of regulatory theory. While several submitters spoke to the clear objective of ensuring that the pension deal is honoured (i.e. benefit security), many are equally concerned about the risks of over-regulation, complexity, cost and bureaucracy. As the "baby boomer" generation moves into retirement age with concerns about the adequacy of their retirement incomes, there is a growing appreciation that pension plans serve a legitimate social policy purpose (i.e. contributing to overall retirement income security) that is worthy of being fostered by the pension regulatory regime.

Although the Panel received comments in submissions reflecting a range of views on what the objectives of the legislation should be, the underlying themes were quite consistent and included:

- ensuring that plan sponsors adhere to the pension deal, or that the pension promise be clarified
- increasing certainty for plan sponsors and protection of member benefits
- for negotiated cost multi-employer plans, ensuring fairness of benefits and equity among members, rather than benefit security
- increasing or encouraging occupational pension plan coverage, and/or not hindering investment
- promoting the growth of DB pension plans
- simplifying standards to encourage coverage
- balancing the objectives of protecting benefits and encouraging plans to continue
- setting out the underlying social policy objectives, so as not to leave them to the discretion of the regulator

While regulation protects consumers, it also imposes costs. As financial sector regulation has evolved over time, the associated regulatory costs have become a concern for business and policy makers. Excessive regulatory costs can negatively impact consumers in a number of ways:

- The costs of regulation may be passed on to consumers through pricing.

- If suppliers cannot pass on costs to consumers, they may be driven out of business.
- Over-regulation can encourage evasion – driving commercial activity underground.
- Over-regulation can act as a disincentive – potentially reducing or eliminating the particular service or product.

In a mandatory system, although the disincentive risk would be eliminated, the other risks of over-regulation (negative impacts on competitiveness, increased costs of doing business and price increases) would still be present. While some governments internationally have moved to mandatory systems for workplace pension plans (Australia, United Kingdom), such a change within Canada would be very difficult because much of pension regulation is under provincial jurisdiction. Imposing a mandatory system in only one or two provinces would increase employers' costs and could negatively impact their competitive positions vis-à-vis employers in other provinces.

In our current system, employer-sponsored pension plans are established at the discretion of the employer. Therefore, if the prime objective of pension regulation is to protect the interests of the beneficiaries, legislators must strike a delicate balance, ensuring that in their zeal to protect the worker, they do not drive employers out of the system altogether.

Many alternate forms of retirement savings or other savings arrangements have arisen in the employment context in recent years as some employers have sought to avoid the cost, complexity and legal and financial uncertainty of the current pension regulatory system while some employees have sought greater flexibility. Such arrangements may not be geared towards security of incomes in retirement for workers.

The last few decades have seen a global wave of attempts to streamline existing regulatory structures in the financial sector and to systematize the creation and review of new ones. "Deregulation," "smart regulation" and "principles-based regulation" have all been popular concepts in recent years. Efficiency of regulation has become a focus, and efficient regulations may only be said to exist where:

- the total benefits to some people exceed the total costs to others; and
- the costs imposed on the regulated are not so excessive as to unreasonably restrict or eliminate the regulated service.

Therefore, like so many other aspects of pension regulation, even the objectives of the legislation must be carefully weighed to "find a balance": 100 percent benefit security is only worth something if benefits continue to be offered. Clarifying the pension promise is important, but only if employers are willing to make the promise in the first place.

Panel Perspectives and Recommendations

Pension standards legislation is necessary if pensions are desirable from a social policy perspective. Legislation can encourage or discourage, mandate or prohibit certain behaviours. The Panel is strongly of the view that occupational pension plans serve a legitimate and important social policy goal, by virtue of their important role in the provision of retirement income security. Proliferation of participation in pensions should result in reduced, or at least no increase in, reliance on social programs by retirees. However, if the rules that are in place in pension standards legislation are counter-productive to the establishment and maintenance of plans, then coverage levels will continue to decline.

In order to stem the tide of declining coverage, the Panel believes that the governments must take concrete action today. The development of next generation pension standards must involve a "fundamental re-thinking" of the legislation. The Panel supports new legislation that appropriately balances the equally valid goals of expanding coverage and protection of the interests of all participants in the system. Achieving this result and addressing the recommendations made by the Panel in this report will require a comprehensive re-write of the existing legislation.

The governments, through pension standards legislation and other policy initiatives, can play an expanded role in promoting coverage. The objective of most current pension legislation is member protection. While important, that cannot and should not be the only goal, and should not be permitted to impede what the Panel believes is the more significant goal of broader pension plan coverage levels. The interests of workers are not protected if they have no pension plans. If there are no pension plans, there will be nothing to protect. In developing objectives of the legislation, the governments must keep that critical fact in mind.

Legislation developed with the goal of improving private sector pension plan coverage levels, should it succeed, is also likely to have the positive side-effect of facilitating the development of pension funds as significant pools of capital that can be re-invested in the economy. While the Panel does not believe this should be an objective of the legislation in and of itself, healthy and well-funded pension plans inevitably develop into sophisticated investors whose presence in the capital markets is being increasingly felt in the economy.

Beyond changes to pension standards legislation itself, governments can and should consider other mechanisms by which the policy objective of establishment and maintenance of pension plans can be encouraged. Registered pension plans currently receive favourable tax treatment with respect to the deductibility of contributions to the plans and the deferral of tax on pension fund investment earnings and on plan members' accrued entitlements. However, current coverage levels indicate that this favourable treatment is not sufficient on its own. The Panel believes that the governments of Alberta and British Columbia, together and in consultation with the federal government, should consider what additional incentives could be provided through tax treatment or otherwise to facilitate achievement of the policy goal of greater pension coverage.

Notwithstanding their important role, occupational pension plans are just one of the "three pillars" of the retirement income system. Any individual's aggregate retirement income will likely be comprised of amounts drawn from two or all three of the pillars (or, if only from one, then from the "first pillar" of government programs, such as CPP/OAS/GIS). Whether that aggregate income is "adequate" is a subjective evaluation. Retirement income adequacy is certainly a broad policy concern of the federal and provincial governments. However, in the Panel's view pension standards legislation is not the only or even the main policy instrument to address that concern due to the inherent subjectivity involved and the varying degree to which occupational pension plans are an element of compensation in any particular employment context.

The Panel is also of the view that pension standards legislation should not be used as an instrument for unrelated social and economic policy objectives. Because of the concentration of capital in pension plans, there is a temptation to superimpose other, unrelated social policy objectives on assets held in pension plans. Similarly, pensions can be, and indeed in the past have been, seen as instruments for labour market planning objectives and other social policy purposes such as protection of spousal rights. However, while the Panel acknowledges that some of those prior social aims are unlikely to be reversed (nor should they be), allowing pension standards legislation to be used as a mechanism to achieve other new objectives risks distracting plan sponsors and other participants in the pension system from the primary and fundamental purpose of pensions. That purpose should be to encourage and achieve stable and secure retirement income for members while providing sponsors with an attraction and retention tool that is considered to have value to the business involved.

The Panel recommends that:

6.1-A The governments should commence a comprehensive re-write of the EPPA and the PBSA based on the recommendations contained in this report.

6.1-B The governments should acknowledge as a matter of public policy that the retirement income system is based upon the "three pillars", and should have as a stated policy objective the expansion of "second pillar" coverage in Alberta and British Columbia through the establishment and maintenance of occupational pension plans.

6.1-C The governments, together and in consultation with the federal government, should consider the provision of additional incentives to existing and potential plan sponsors and employers, beyond deductibility of contributions and deferral of tax on investment earnings and benefits, to encourage the establishment and maintenance of pension plans and greater pension plan coverage.

The issue of mandatory coverage in occupational pension plans for all workers is the subject of significant debate. Of course, not all working people value a pension plan in the context of their work arrangement, while some (in particular, the self-employed) do not have an "employer" in the traditional sense. The Panel's view is that employers and employees should be the ones to determine the most appropriate mix of compensation in their context, including whether they should have an occupational pension – which is but one pillar of the pension system. Imposing a requirement for mandatory coverage where none exists today could impact the financial viability of some businesses, which certainly does not serve the interests of workers who might then lose their jobs. If a mandatory component to the system is desirable, the Panel believes that it should be structured through the public pillar. Only through that pillar would it be possible to ensure full coverage for any program.

In order to attain the broadest possible coverage levels under the occupational pension plan pillar, pension standards legislation needs to encourage pension coverage, and certainly must not discourage employers and employees from seeing and appreciating the utility and value of an occupational pension plan. One important way to do this is by reducing impediments to the establishment and maintenance of plans perceived, rightly or wrongly, to exist under current legislation. The Panel believes that the legislation needs to allow plan administration to be as simple and cost-effective as possible. Minimizing the complexity of pension legislation, and thereby simplifying administration, would make pension plans a more attractive and affordable component of an employer's overall compensation package. In turn, this approach would assist in making Alberta and British Columbia known as jurisdictions where it is easy to do business.

The Panel is also of the view that the legislation should allow employers and employees to determine the most appropriate form and structure of pension benefits to be delivered in their particular situation, without being forced into a decision on plan design by rules contained in the legislation. Legislation should facilitate creation of a variety of plan types, such that employers and employees can determine what features of a plan (attraction, retention, simple savings, etc.) are relevant and important in their context. The appropriate allocation of risk and reward and of governance responsibilities should then be left to the parties. Adopting this approach would allow plans to be meaningful to employees and affordable (in both cost and potential liability) to employers. (See further discussion in Section 6.3 "Alternative plan designs" below.)

With this added flexibility in the legislation, however, should also come the added responsibility for the parties involved to ensure that whatever promises are made in the design of a pension plan will ultimately be delivered. In the Panel's parlance, our view is that the legislation should allow the parties to "define the deal" and then contain sufficient safeguards to ensure that "the deal" is delivered. This approach would permit the balance between benefit security and cost certainty to be left to the design chosen by the parties. The role of the regulator (discussed in greater detail in Section 6.4 below) should be to ensure that the promise is clearly articulated and is being kept. Fairness and security of benefits would be fostered with increased focus on the nature of the promise being made, and allowing employers and employees to set their own "pension deal".

The Panel's focus on expansion of coverage should not be perceived as diminishing emphasis on the security of benefits. This need not be the case with the legislation that focuses on the enforcement of the "deal". While it is difficult to envision a practical and affordable system that encompasses both 100 percent coverage and 100 percent benefit security, ultimately, streamlined and flexible legislation should facilitate improved coverage levels without any significant impairment of benefit security. The challenge, which the Panel hopes can be met by implementing the recommendations in this report, is to create a legislative scheme that achieves an appropriate balance of measures designed to achieve both of those goals at acceptable levels.

The Panel recommends that:

6.1-D The legislation should have the following primary objectives:

- **facilitating coverage by reducing barriers causing sponsors to be unwilling or unable to establish or maintain occupational pension plans**
- **setting streamlined minimum pension standards with effective enforcement powers, while providing maximum flexibility, simplicity and clarity to facilitate the establishment and maintenance of plans**
- **avoiding over-regulation that could deter employers from participating in the occupational pension system**
- **ensuring that pension promises made in this new context are kept**

Whether pension standards legislation itself should contain a statement of its primary objectives is subject to debate. There is merit in the legislation providing a clear enunciation of the purposes of pension plans, and clear guidance to the courts and/or administrative tribunals in interpreting the legislation. Such a statement would also be consistent with a principles-based approach to regulation.

However, the application of such guidance may have unintended consequences; for example, where the courts or an administrative tribunal interpret the statement of objectives broadly as having overarching application to all of the other provisions of the statute. The overarching policy objectives of the legislation may be different from compliance objectives of the regulator, and as a result, may create issues for the regulator's ability to enforce the legislation as written. If, for example, the regulator must take into consideration the impact of any enforcement action it might wish to take on the level of pension coverage, the regulator's ability to properly administer the legislation may be impaired. At a minimum, it should be clear that the regulator's objectives are only a sub-set of the objectives of the legislation and that it is not the role of the regulator to promote pension coverage.

The Panel recommends that:

6.1-E The objectives of the legislation should be clearly stated at the time it is brought before the legislature. However, the legislation itself should not contain explicit statements regarding objectives, and the provisions of the legislation should stand on their own. Those provisions should be properly designed so as to achieve the objectives referred to in Recommendations 6.1-B and 6.1-D.

One of the significant challenges that has faced the pension system in Canada over the past two decades has been the uncertainty created by the application of case law to pension matters. However, recent decisions of the courts have started to recognize that common law principles should be restricted in their application to pensions where a statutory scheme exists with respect to any matter at issue.

More than one court in Canada has commented that the myriad pension issues brought before the courts are in dire need of legislated solutions. Where the courts have definitively spoken on an issue, incorporating such decisions into the legislation or consciously creating different rules on the point would enhance certainty for those involved in the pension system. Where no definitive judicial view exists, the Panel believes it is the role of government to resolve uncertainty by legislation.

Another challenge faced by pension plan sponsors and members has been changes in the regulatory landscape resulting from changes in professional standards (e.g. actuarial and accounting standards) that are incorporated into pension standards by reference. While these standards are a necessary element of the system for certain types of plans, the Panel is of the view that the legislation should more closely control the application of standards developed by self-regulated professions. It should not be left to professions to dictate them without conscious adoption by government. To do so is, in the Panel's view, an abdication of the government's role and allows pension policy to be developed without transparency.

The Panel recommends that:

6.1-F Pension standards legislation should address all currently foreseeable matters relating to pensions, including those that have been considered by the courts to date, in order to incorporate those matters into a comprehensive legislative framework to the extent possible.

6.1-G Where professional standards are to become legislative requirements, they should be specifically identified, and changes should be adopted only if reviewed and agreed to by the governments.

6.2 Principles-based vs. rules-based legislation

Issues

To what extent should pension standards legislation establish principles as opposed to specific rules governing the conduct of those involved in providing occupational pension plans?

Discussion

The term "principles-based legislation" refers to a legal framework that is based on broadly stated principles rather than detailed rules. In the regulatory context, principles-based legislation involves the use of broad principles to set the standards by which regulated entities must conduct their activities. In a principles-based framework, these high-level principles replace many of the traditional prescriptive rules – but may also be supported by some detailed provisions (perhaps dealing with only limited elements of the legislative subject matter) most often in the subsidiary legislation (i.e. regulations or rules). The theory of principles-based legislation has received considerable attention in the financial services sector over the past decade.

The existing legislative framework in Alberta and British Columbia may be best described as largely "rules-based" or "prescriptive." However, it does contain some notable principles, as well as some provisions that combine both principles and rules. The general fiduciary standard to which plan administrators are held is essentially a principles-based provision, while current investment rules employ both principles (the "prudent investor" standard) and rules (the "quantitative investment limits").

Governments have been increasingly interested in principles-based legislation as an alternative to the traditional approach to regulation whereby a myriad of detailed rules are designed to prescribe regulated behaviour. It has been held out as a vehicle for simplifying legislation, improving consumer protection and reducing the number of detailed regulations imposed on business.

While principles-based legislation is promoted for its conceptual advantages of greater flexibility, deregulation and a more collaborative regulatory approach, it carries its own risks. Lack of certainty, inappropriate skills in the regulator, inconsistent application of principles and enforcement are all concerns that must be considered before a principles-based regulatory approach should be adopted.

The benefits of principles-based legislation are generally summarized as follows:

- *Flexibility* – Because principles tend to focus on outcomes, they can be designed to be clear and easily linked back to the objectives of the regulatory framework. Because they focus on the purpose behind the requirements, principles are more enduring – they can accommodate innovations as long as they are used in a manner that achieves the ultimate objective. These characteristics make principles more flexible, allowing regulated entities to design their own approaches to compliance and facilitating innovative products, strategies and internal processes. In the pensions context, the use of principles may help to stimulate improved plan designs that meet the objectives of workers and employers in the future, without having to change the legislation as each innovation comes to light.

- *Promoting Compliance* – Because they focus on outcomes, principles articulate the objectives of regulation rather than what specific steps must be taken in a particular circumstance. By emphasizing the desired outcome, principles-based legislation promotes behaviour that will achieve its objectives and minimize "creative compliance" or "compliance by loophole." Raising regulatory requirements to higher level concepts tends to engage senior management in the regulatory process, bringing a more strategic approach to bear in regulated entities and making it more likely that regulatory objectives will be addressed in overall organizational governance and internal control policies. In the pensions context, this could improve overall compliance and benefit security.

- *Streamlining* – Another potential benefit is a general "decluttering" of the legislation. By focusing on key principles instead of a confusing labyrinth of rules, the legislation can be streamlined and clarified. Although detailed rules can contribute to clarity, too many rules can also cause confusion, defeating the objective of certainty.

The risks and challenges of principles-based legislation include:

- *Uncertainty and Unpredictability* – In any regulatory system, there must be a high level of shared understanding between the regulator and the regulated as to the meaning of particular requirements. It must also be possible for regulated parties to predict, at the time of the action concerned, whether or not it is a breach of a requirement. Uncertainty has also been identified as a risk from the enforcement perspective. Working with broad principles can present a challenge to the regulators, who may not be readily equipped to enforce them with little detailed guidance. In order to develop the "shared understandings" that are required in a principles-based environment, regulators and regulated entities must be prepared to undertake an ongoing dialogue as to the objectives of the regulatory regime, their respective roles and responsibilities in achieving them and the interpretation and application of the regulatory requirements.

- *Skills and Culture of the Regulator* – Regulating according to principles requires significant changes in the relationship between the regulator and the regulated. Departing from a prescriptive, checklist approach means that more judgment calls are required. In order to be equipped to make these calls, the regulator must generally improve its understanding of the regulated industry and some of the underlying challenges faced by plan administrators. The regulator must be in a position to support regulated entities by offering the certainty and predictability that will allow them to develop their own approaches to the principles. This requires that the regulator move to a more educative and advisory approach to supervision, and away from traditional punitive responses. For example, policy guidelines from the regulators explaining how they intend to interpret and enforce specific principles would be an important element of a principles-based framework.

- *Skills and Mindset of the Regulated* – Where standards are articulated as broad principles instead of a detailed list of requirements, it is incumbent on the regulated to take a more holistic approach to compliance. Senior management needs to be more closely involved in developing their own objectives in the context of the regulatory framework, and compliance staff must be able to elaborate on and enforce the principles within their own organizations. Everyone involved must have the capacity to make more judgment calls to evaluate whether their specific actions are in compliance with the broader principles.

- *Enforcement* – Effective enforcement of broad principles is also a potential challenge. Measuring compliance with step-by-step processes that can be monitored and documented is a much more straightforward task than evaluating whether appropriate outcomes are achieved. One of the enforcement risks is the potential for over-zealous enforcement action, possibly resulting from decisions made retroactively about the interpretation of broadly stated principles. On the other hand, there is a potential danger that uncertainty could lead to "over-compliance" – regulated parties adopting overly conservative courses of action to protect themselves from unpredictable regulatory responses. Approaching compliance on the basis of an evaluation of due diligence could, in itself, create incentives for managers to strengthen internal controls and improve governance, because they receive credit for these precautions. The "prudent person" standard as applied in practice, however, demonstrates that it is very important to be clear, while crafting principles, about what outcome is expected.

- *Harmonization* – A move to principles-based legislation may be challenging for maintaining harmonization, as even with identical principles there is an increased risk that they may be applied differently by different regulators. Maintaining harmonization in a principles-based framework may require new processes and/or the establishment of new entities whose role would include the promotion of harmonization.

A review of the submissions received by the Panel reveals broad-based support for incorporating more principles into pension standards legislation. Several submitters offered unqualified support for a principles-based approach in order to provide the flexibility required to acknowledge the changing reality of pension plans and business generally. However, the majority of stakeholders supported combining principles with rules where it is possible and desirable to have clear and specific standards. One submission suggested that guiding principles be contained in the legislation, with more specific rules set out in the regulations or in regulatory policies, where it would be less complicated to change specifics to reflect changing economic realities. This suggestion is consistent with the approach taken by CAPSA in its *Report on CAPSA's Work on*

Regulatory Principles for a Model Pension Law 2008. Among those supporting a mix, opinions differed as to the appropriate balance between principles and rules.

Those submitters who did not support the concept of principles-based legislation expressed concern that principles would not provide adequate guidance for regulators or pension plan sponsors, administrators and members, resulting in lower standards and increased litigation, or that it would essentially amount to the deregulation of pensions.

Panel Perspectives and Recommendations

The Panel recognizes the general appeal of a principles-based approach to pension standards legislation in providing greater responsiveness to innovation and market developments, greater freedom for plan sponsors to develop their own approach to compliance, promoting a culture of compliance and withstanding changes in the regulatory environment by addressing overarching objectives rather than detailed processes. That said, it should be emphasized that a principles-based approach does not mean self-regulation, voluntary compliance or deregulation. The Panel also appreciates the practical reality that those involved in day-to-day administration of occupational pension plans tend to favour the certainty of a rules-based approach and may be resistant to operating with only principles to guide certain aspects of plan administration.

A significant number of rules with which sponsors must comply seem to have little impact on members' benefits and other entitlements, and at the same time require sponsors to expend considerable time, energy and resources in order to comply. The Panel is supportive of an approach to pension standards legislation that would minimize unnecessary or overly burdensome rules to the extent possible.

The Panel does not believe, however, that it would be practical to expect that a purely principles-based approach would either be feasible or desirable. Some areas of pension legislation are more suited to principles-based standards (e.g. governance, investments). There is also a need for rules-based standards of general application in specific areas (e.g. vesting, locking-in, disclosure, spousal rights, minimum DB funding). It is not possible, though, to determine all necessary and appropriate rules today for new plan types or designs that may be developed in future. Mechanisms are needed to respond quickly to new models as and when they arise. Ultimately, plan members, sponsors and administrators want the certainty of rules in some areas, with the flexibility of principles in others.

The approach that the Panel has found most appropriate to endorse can be summed up as: "principles where possible, rules where necessary." Concerns that a solely principles-based approach lacks the certainty and security of rules and provides too much flexibility to sponsors can be addressed by using rules in appropriate areas where specific standards are necessary and principles in areas where more flexibility is appropriate.

Moving from the prescriptive rules-based approach taken in current pension standards legislation to more of a blended principles/rules approach would involve addressing certain key factors in order to be successful:

- *An appropriate balance between rules and principles* – In some cases, a broad principle will not provide enough guidance even for a knowledgeable regulated entity to know how to comply. Some detailed rules will always be necessary to support the principles. One of the critical success factors for a more principles-based approach is knowing when to use principles and when to use detailed rules.

  In considering whether a principle, a rule, or a combination of both is appropriate for any particular requirement, a number of factors are relevant:

  - Who is expected to be involved in compliance (i.e. is it likely that a professional service provider, such as an actuary, investment manager or lawyer would be involved, e.g. with the design of a new plan, the investment of assets or the development of a funding policy)? If professionals are likely to be involved, detailed guidance may not be as important as in circumstances where the administrator will not be likely to receive professional advice (e.g. disclosure requirements).
  - Is there already a common law principle that is well understood, and provides guidance on the particular issue (e.g. the prudent person principle)?
  - Is the requirement one that is intended to cover innovations that may be developed in the future? If so, a broad principle may be more appropriate than a specific rule that is not flexible enough to address future developments (e.g. new plan designs).
  - Is it necessary to have uniformity or comparability of inputs, rather than outcomes? If so, a detailed rule may be appropriate so that all market participants are using a comparable base.

- *Providing accessible and consistent guidance* – The role of the regulator in a principles-based environment necessarily involves more education and advice than in a traditional rules-based framework. It requires a more collaborative approach to regulation – one that provides regulated parties with a clear understanding of how the regulator intends to interpret and approach enforcement of principles. This could be accomplished by requiring or encouraging the regulator to publish more regulatory guidance policies on various issues dealt with in the principles. At the same time, the temptation to provide an overwhelming volume of guidance must be avoided, as this can defeat the original objectives slipping back into so much detail that the principles are lost and confusion abounds.

- *One size does not fit all* – It is often suggested that principles-based legislation is not appropriate for smaller organizations that may lack the resources and expertise to develop compliance approaches to broad principles. For pension standards, regulatory guidance including sample documents may be helpful for smaller organizations that do not have adequate resources to operate within a principles-based regulatory framework. Alternatively, such organizations might prefer to participate in a plan of the type discussed further in Section 11 of this report.

- *Involving the regulated industry in the development and interpretation of principles* – One of the most important features of a successful principles-based model is the involvement of those that are regulated in the development of principles and their interpretation. For example, this has been demonstrated in the development of the governance principles contained in CAPSA's *Guideline No. 4: Pension Plan Governance Guidelines*, which are the product of intensive consultation with, and are generally accepted by, the pension industry.

The Panel recommends that:

6.2-A Pension standards legislation in Alberta and British Columbia should be reconstructed to adopt an approach employing principles wherever possible, supported by detailed rules where necessary. Elements of this approach include:

- **principles setting certain criteria of general application, regardless of plan type;**
- **rules-based standards in some specific areas; and**
- **different rules applicable to different types of plans, as appropriate. (See also Section 6.3 "Alternative Plan Designs" below.)**

6.2-B Where principles are appropriate, they should be set out in the pension standards statute, supported by more detailed rules that may be subject to more frequent change in the regulations, to ensure that sponsors can manage plans in a manner that provides some confidence as to their obligations.

6.2-C Regulatory policies and guidelines should be developed to provide guidance to plan sponsors, administrators and members on compliance with principles-based standards.

6.2-D The regulator should have the discretion and resources necessary to properly fulfill its role in the context of a principles-based system. (See also Section 6.4 "Role of the regulator" below.)

6.2-E In light of the recommended increase in the discretion of the regulator in a more principles-based system, an adjudicative body should be established to hear appeals from the exercise of that discretion, acting as a "check and balance" within the regulatory system. (See also Section 6.4 "Role of the regulator" and Section 6.5 "Harmonization" below.)

6.2-F Future refinement of the principles in the legislation and the regulatory interpretation thereof should be developed in consultation with an appropriate pension policy advisory body. (See also Section 6.4 "Role of the regulator" and Section 6.5 "Harmonization" below.)

6.2-G To maintain consistency of interpretation of harmonized legislation, regulatory guidelines should be developed in consultation with the recommended pension policy advisory body and based on agreement between the regulators in each of Alberta and British Columbia. (See also Section 6.4 "Role of the regulator" and Section 6.5 "Harmonization" below.)

6.3 Alternative plan designs

Issues

In the context of a pension regulatory system geared towards expanded coverage and increased principles-based flexibility, a number of issues pertaining to the existing legislation must be considered:

- Is "one-size-fits-all" pension standards legislation adequate, or should there be different rules for different pension models? If so, how should they vary?
- 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?
- Are there new plan designs, including approaches adopted in other jurisdictions inside or outside Canada, which should be specifically contemplated in the legislation?

Discussion

A common complaint heard regarding existing pension standards legislation in Alberta and British Columbia is that it has not kept pace with changes in the way pensions are delivered today. For example, those involved in negotiated cost multi-employer plans are concerned that the traditional DB solvency funding rules do not work well in the context of plans where contributions are collectively bargained (see also Section 8.2, "SCTB funding and related rules" below). Sponsors of DC plans whose members make their own investment decisions are not exempt from the requirement to maintain a statement of investment policies and procedures ("SIPP").

Current pension legislation in Alberta and British Columbia had its genesis at a time when the traditional single-employer DB plan was the norm for occupational pension plans. As new or different plan designs came into existence or became more popular (such as DC plans and multi-employer plans, changes were made to the legislation on an ad hoc basis in order to fit such alternate forms of plans within the scope of the legislation. However, most of the standards in the legislation continued to apply on a "one-size-fits-all" basis.

There are logical reasons why this is the case. Comprehensive review of pension standards legislation has typically occurred in Canadian jurisdictions only every 20 or more years. Between such reviews, the regulator needs to be able to do its job overseeing plans based on the legislation then in place. With the myriad of competing priorities facing governments, it is understandable that only changes that are absolutely necessary tend to find their way onto the legislative agenda.

However, the result of a patch-work approach to pension standards legislation is that it often cannot keep up with the pace of change in the economy. This results in a perception by plan sponsors and members that the legislation is inflexible, prescriptive and out of touch with modern realities facing plans.

In submissions made to the Panel, stakeholders expressed a general desire for increased flexibility in the legislation. A strong theme also emerged from the submissions that different types of plans should be subject to different rules that are customized to the nature of the plan. Nonetheless, there was also concern expressed that increased flexibility not result in a weakening of the standards and benefit security for plan members and retirees.

A wide variety of alternatives to the typical DB, DC and multi-employer designs has been developed in other jurisdictions in recent years, while some successful alternatives have existed for longer periods of time. Examples of these alternate designs include the Australian superannuation plans, the KiwiSaver plan in New Zealand, personal accounts in the United Kingdom, the TIAA-CREF plan in the United States and, closer to home, Quebec's simplified pension plan and member-funded pension plan and the Co-operative Superannuation Society Pension Plan in Saskatchewan. Many other potential structures have also been proposed by professional firms and academic commentators. (See also Appendix B "Alternate Plan Structures" for a summary of the characteristics of some of these alternative plan designs.)

A few commonalities in these alternative plan structures stand out. First, most of the plans were developed in response to a worry about the high number of people who are either not saving enough, or not saving at all, for their retirement. Sometimes this worry was about a certain sector of the workforce, other times it was concern about workers in general. The new plans have often addressed this concern by making membership mandatory or enrolment automatic with an opt-out provision. These options were chosen because purely voluntary schemes were viewed as having low participation which would not address the underlying concern of low coverage. Second, these plans have reduced risk to employers. Most of the plans operate as DC plans from the point of view of the employer, although some offer DB-type retirement promises for members. Third, these plans are often encouraged through tax incentives that either defer or reduce tax on contributions and investment earnings. Fourth, many of these plans employ governance structures that vary from the typical structures required under existing legislation in Alberta and British Columbia. Fifth, many of these plans are predicated on the advantages that can be obtained from economies of scale and professional management.

Whether any of these specific structures would gain favour in Alberta and British Columbia is difficult to anticipate under the current framework. With legislation that permitted or facilitated such designs, some might work, some might not. However, a move towards a more flexible, principles-based approach, as discussed in Sections 6.1 and 6.2 above, with some standards of general application to all plans, would permit the necessary flexibility for potential positive innovations in plan design. An example of a possible innovation is discussed further in Section 11 of this report.

Any such change to permit more flexibility for alternate plan structures would have implications for the role of the regulator. In such a system, the skills required of the regulator would change from monitoring compliance with a set of rules-based standards to exercising judgment and discretion in evaluating whether any new form of plan satisfies the principles applicable to all plans and monitoring the plan's ongoing compliance with those principles. (See also Section 6.4, "Role of the regulator" below.)

Panel Perspectives and Recommendations

The Panel is of the view that much of the terminology that describes existing plan designs permitted under pension standards legislation in Alberta and British Columbia – single-employer versus multi-employer, DB vs. DC – reflects outdated thinking. The next generation of pension standards legislation needs to get past these limited notions and focus on facilitating the development of plans based on the critical success factors for any type of pension plan (i.e. good governance, large scale, professional investment expertise, pooling of as much risk as possible, appropriate contribution levels to achieve the goal or "deal").

Plan design decisions that are forced by prescriptive rules do not serve the interests of employers, workers or retirees. As discussed in Section 6.2 above, the Panel believes that plan sponsors and members should have the flexibility to define whatever pension "deal" is most appropriate in their circumstances. The role of pension standards legislation, and of the regulator, should then be to ensure that reasonable protections are in place to ensure that the deal made is actually delivered.

The Panel supports "next generation" pension standards legislation that would accommodate new and innovative plan designs without the need for constant changes to the legislation. The legislation should require that the plan documents define what the deal is, what the risks are and who bears them, and who has the governance responsibilities to ensure that the promises made are kept. With this approach, the legislation does not need to contain specific rules for new permitted plan types. Rather, the legislation should define principles of general application to all plans. Rules, as necessary, for different types of plans (and, in particular, the rules associated with existing plan types) should be contained in regulation, or in regulatory policies or guidelines that help in the interpretation and application of the principles to such plans. Developed in this manner, the next generation of the legislation might well be the last generation needed, as flexibility would be inherent in the system and necessary rules would be housed where they can be changed more easily as circumstances evolve.

Similarly, the Panel believes that the legislation should be flexible enough to accommodate different plan governance models and should facilitate models that give governance responsibilities to those bearing the risks. In order to open the door to other governance structure possibilities, the definition of the "administrator" should be broadened to contemplate this flexibility.

While current governance structure options permitted by the legislation generally work well and serve the interests of the parties to the "pension deal", they require that all pension plan administrators be either the employer or a board of trustees. In some circumstances, it may be more feasible to have another party take on the role of administrator. For example, a not-for-profit entity created with objects centred on acting as a pension plan fiduciary is potentially a desirable governance structure alternative, subject to the availability of sufficient resources or liability insurance to back-stop its fiduciary obligations.

The Panel does not believe, however, that the scope of the types of entities permitted to act as the governing fiduciary of a pension plan should be unlimited. In the Panel's view, there is a fundamental conflict of interest for a profit-making entity, other than the employer, to act in a fiduciary role with respect to plan beneficiaries. The one exception that the Panel does believe constitutes a viable option would be profit-making entities that are subject to regulation consistent with the objectives of pension standards, including financial institutions such as banks, credit unions and insurance companies.

The Panel recommends that:

6.3-A The legislation should contain principles of general application to all pension plans, including, without limitation, principles dealing with eligibility to participate, vesting of entitlements, locking-in of benefits, portability of benefits, segregation of assets, the role and identity of the governing fiduciary and how the "pension deal" is to be defined.

6.3-B Different rules should be developed that are appropriate to different existing and future plan types, and such rules should be housed in regulation and/or regulatory policy.

6.3-C The next generation of pension standards legislation in Alberta and British Columbia should be designed to permit flexibility in the development of new plan design types, subject to adherence to the principles of general application.

6.3-D New plan types should be permitted and registrable under pension standards legislation.

6.3-E Employer contributions should not be a necessary element of a registered pension plan. RRSPs, however, should continue to be exempt from pension standards legislation.

6.3-F The legislation should be designed to permit flexibility in the development of new governance structures, and in particular, to allow for more options as to who can be an administrator of a pension plan. However, the role of governing fiduciary should be restricted to existing permitted entities, not-for-profit entities with sufficient capital or liability insurance or for-profit entities subject to regulation consistent with the objectives of pension standards.

6.4 Role of the regulator

Issues

In light of the foregoing recommendations made in Section 6.0, a number of implications for the role of the regulator must be considered:

- How far should the regulator's mandate extend? Should the regulator's role be restricted to enforcement of minimum statutory standards only, or extend more broadly to assess whether pension plans are being administered in a safe and sound manner using best practices? Should it include enforcement of the terms of the plan documents?
- Should the regulator have the ability to approve new pension plan designs? If so, should the regulators have the ability to impose conditions on registration of specific plans or impose additional requirements on certain types of plan models?
- More broadly, should the regulator's role extend to promoting the establishment and retention of pension plans, or expanding coverage?
- How would moving to principles-based legislation change the regulator's role?
- Is there a need for an independent "pension advocate", whose key objective would be to promote the pension system?

Discussion

Pension standards legislation in Alberta and British Columbia dictates the role of the regulator in monitoring the terms and operations of plans. The legislation, by virtue of the duties imposed on the regulator, sets the objectives for the person (office) charged with the administration and enforcement of pension standards.

For purposes of clarity, in this document the term "regulator" refers specifically to the person or office charged with administration and enforcement of pension standards, not to the government that appoints the person or creates the office or to the politicians who are the ultimate decision-makers on pension policy and legislation.

Objectives of the regulator

It is generally agreed that a key role of the pension regulator is to administer and enforce pension standards legislation. Some have argued that the role of the regulator should go beyond this – that there should be an overriding role of promoting the pension system, expanding pension coverage and/or increasing financial literacy. Whether the regulator should be responsible for promoting these social policy objectives, and whether this role should be reflected in the statute, are topics of some controversy.

It is a basic principle that regulators must conduct day-to-day regulatory activity without political interference, and that provisions of the legislation are to be applied consistently, fairly and objectively. This principle is often reflected in an outright structural separation of day-to-day regulatory activity from the policy function (as presently exists in British Columbia); but even without a structural separation (the current model in Alberta), the theoretical divide between day-to-day regulation and the development of policy is generally still respected as a matter of "best practices."

A review of regulatory models across Canada shows that, although there is a range of regulatory structures, the following features are generally consistent:

- regulators are charged with the day-to-day conduct of regulatory activity
- regulators operate without political interference
- government provides overall policy direction
- regulators are responsible for administrative policy
- regulators provide input on government policy

Historically, the regulator has been expected to administer and enforce the provisions of the legislation on their face – without any overriding policy objective. This is consistent with the theory that day-to-day regulation must be independent of political considerations. Similarly, the courts have traditionally avoided referring to policy intent, unless the legislation on its face is determined to be unclear. In a perfect world, where every possible event and situation has been predicted and addressed clearly in the statute, the regulator and the courts may never have to apply discretion in interpreting the legislation.

In the real world, however, we know that it is unrealistic to expect the statute to contemplate every possible scenario, especially in complex areas like financial sector regulation. Furthermore, there is an international trend toward a more principles-based form of regulation – with broad principles providing little detail on the exact elements of compliance. When the legislation does not clearly address a particular circumstance, or when the legislative standard is set out as a broad principle, both the regulator and the courts must consider policy intent, industry standards, common law or other relevant factors in making regulatory decisions.

The suggestion was made in submissions to the Panel that social policy objectives should be clearly set out in the legislation, and not left to the discretion of the regulator. Arguably, if the regulator is expected to consider such objectives, reflecting them in the statute is the best approach. If policy objectives are intended to influence regulatory decisions, then they should be set out in a manner that leaves no room for speculation as to what they might be. If the statute is intended to be a code that pension system participants (including the regulator, plan administrators, plan beneficiaries, service providers and the courts) can rely on, then all factors that are to be considered should be codified.

As discussed earlier in Section 6.1, the objective of promoting the pension system, although worthy, should not be explicit in the statute. If the regulators must enforce legislative provisions on their face, while at the same time being charged with an overall obligation to, for example, promote the pension system or expand coverage, how would they find the right balance each time they are faced with apparent conflicts between the two objectives?

Many stakeholders have argued that the legislation must provide more certainty. At the same time, many stakeholders also support a move to a more principles-based approach, consistent with the trend in financial regulation.

Codifying an obligation on the regulator to "promote the pension system" or "expand pension coverage" would, in effect, overlay a broad principle on the regulator's specific powers. This may cause confusion for all concerned. Regulators would theoretically need to balance expanding coverage with, for example, cancelling a registration, potentially resulting in increased litigation and, arguably, more confusion.

In Recommendations 6.1-D and 6.1-E above, the Panel supports clear objectives for pension standards legislation, without actually resorting to codifying those objectives in the statutes. This is more consistent with the traditional role of the regulator, i.e. that the regulator should enforce the statute as written without being responsible for the promotion of coverage.

If this is the approach taken, it may be necessary for the governments to consider whether there is a need for an independent "pension advocate," whose role would be to promote the pension system, identify barriers and work with stakeholders and government to develop solutions to key pension issues. Otherwise, it is difficult to envision how that objective could be achieved other than by passively awaiting positive response to the other changes made to pension standards.

Risk-based regulation

In today's increasingly sophisticated financial environment, one recent focus of regulatory theory has been how to use limited regulatory resources most efficiently to provide effective protection for consumers. The concept of doing "less with less" has become a challenge that has led to important advances in how regulatory resources are organized and focused to increase the efficiency and effectiveness of regulators.

The term "risk-based regulation" refers to a regulatory approach that relies on risk assessment techniques to determine where best to focus scarce regulatory resources. Risk-based regimes emphasize the need for regulation to be proactive and preventive, rather than reactive and enforcement oriented, and rely on the regulator being selective about the problems targeted for attention.[25] Another notable feature is that they accept some potential for regulatory failure, as they do not contemplate 100 percent regulatory coverage.

In a risk-based environment, regulated entities are assessed based on their internal control systems and relevant risk factors identified by the regulator. Regulatory resources are then allocated based on the relative risk rating of the entities – with regulatory activity focusing on those with the worse risk profiles. In this way, limited resources are devoted to the areas where there is the most potential for failure, and regulated entities' past records and quality of internal controls ultimately determine the extent of regulatory burden they will have to bear.

Moving to a risk-based approach involves more of a change of culture for the regulators than it does any change in policy or legislation, although it is consistent with a move to a more principles-based legislative framework. A risk-based approach to regulating, similar to a principles-based approach to legislation, requires a shift away from a "check-box" mentality for the regulator and a greater emphasis on qualitative assessments of the internal controls and relevant risk factors of regulated entities than the old way of regulating by typically reviewing each of the regulated entities on an annual, two- or three-year cycle, but only in a very routine manner.

Regulators in both Alberta and British Columbia have already embraced a risk-based approach as a more efficient manner of utilizing their resources effectively in today's environment. While they are gradually developing risk profiles for each regulated entity and redesigning compliance programs to focus on those with the greatest risk exposures, they have also identified aspects of the legislation that are inconsistent with a risk-based approach; for example, the current requirements for every plan amendment to be approved.

[25] *OECP Research Mandate #5: Comparative Models of Risk-based Financial Services* – Mary Condon (2007).

As discussed above, in submissions to the Panel, stakeholders were generally supportive of a regulatory framework comprised of a combination of broad principles and detailed rules, although suggestions as to which aspects should be principles- or rules-based differed. Where stakeholders commented on the potential impacts of principles-based legislation on the regulator, it was generally agreed that a more sophisticated approach to regulation, potentially requiring different types of expertise or skill sets may be required.

Stakeholders who did comment specifically on the role of the regulator focused on the need for the regulator to respond more quickly to submissions from sponsors and reduce the regulatory burden on employers. Suggestions to achieve these objectives included:

- adoption of principles-based legislation;
- adoption of a risk-based regulatory model (for example, acknowledging routine amendment requests quickly without in-depth review); and
- separation of general enquiries from plan sponsor-related issues.

It was also suggested that in a principles-based environment, the regulator must have relatively broad policy-making powers (with a requirement to consult with industry stakeholders) as well as adequate resources to ensure the requisite level of expertise in pension matters.

Retiree groups suggested that the prime objective of the pension regulator should be to protect the interests of plan beneficiaries, and that this should be clearly set out in the legislation. It was also suggested that the mandate of the regulator be expanded to allow for proactive monitoring of all aspects of a pension plan, including governance, and that full reviews should be done where it is evident that the plan, its administrator and/or the sponsor are having difficulties.

Panel Perspectives and Recommendations

Regulators are consistently being asked to do more and more supervision with fewer and fewer resources. In the pension system, the only logical response is to ensure that those regulatory activities that are carried out are meaningful and beneficial.

In the Panel's view, the proper role of the regulator is more than simply policing a prescriptive set of rules. This approach carries through our recommendations regarding the objectives of the legislation, a move towards a more principles-based system and the creation of a policy advisory body. The regulator should not operate in isolation from the policy-making function in other areas of the government. The regulator's key role in the pension system means that in acting it must at least be cognizant of the policy rationale behind the legislation. The only way that this can be accomplished is to allow the regulator increased discretion within a system based on increased flexibility, and to involve the regulator in the development and interpretation of the principles contained in the legislation.

However, this conclusion is not meant to imply that it should be the regulator's job to be responsible for promoting all of the recommended objectives of the legislation. Clarity is needed in the legislation with respect to where the regulator is expected to promote the objectives of the legislation, and where the regulator is not. Where it is appropriate for standards to be set out as specific rules, those standards need to be enforced on their face by the regulator. Where the legislation takes a principles-based approach, or the regulator is otherwise provided with discretion under the legislation, the regulator's decisions must be informed by reference to the objectives of the legislation, but the regulator's focus should still be on the pursuit of compliance with the principles-based standards adopted by the legislatures. It is not realistic to expect that the regulator's office could be responsible for simultaneous promotion of potentially competing objectives of the legislation. The resulting conflicts would be more likely to result in an inability to achieve success with respect to any objective.

The Panel believes that the regulator should not be responsible for actively promoting coverage. As referred to above, it would also be inherently difficult and create untenable conflicts if the regulator were required to consider implications for coverage as a factor in its decision-making processes. The regulator should be focused on administering and enforcing the legislation as it is written.

With a shift towards principles and flexibility, opportunity is created for regulation to be more meaningful. Regulatory resources should be focused on a risk-based approach to regulation, concerned with encouraging and enforcing compliance with the principles contained in the legislation. Time-consuming, routine, low-risk matters should not take up limited regulatory resources. While those who prefer a compliance-based model may feel there is less certainty without the traditional comfort of regulatory approvals to routine matters, this approach is becoming less common anyway, as regulators increasingly rely on certifications of compliance by sponsors. Where the parties to the pension deal are permitted to structure a promise appropriate in their circumstances, the role of the regulator will be to ensure that the promise is clearly articulated and is being kept. The regulator needs to have the statutory authority and resources to accomplish risk-based monitoring of pension plan governance and deal with those situations most likely to create poor results in the absence of intervention. Such monitoring must be meaningful and not overly burdensome to plans.

To the extent that the next generation legislation permits new, innovative plan designs, the regulator will have an important role to play in approving such designs against the standards set out in the legislation. The regulator should not have the ability to grant exceptions or permit plans or activities contrary to the principles of general application. However, the regulator should be granted the ability and discretion to prescribe conditions on the approval of the registration of a new plan design. (See also Section 6.4.1, "Regulator's tools and checks and balances in the system" below.)

The introduction of principles where possible would require a transition in the culture and skill set of the regulator from a compliance/policing approach to an approach focused on high-risk issues and implications of decisions. This approach would in all likelihood be more time-intensive in the areas where regulation is focused and may well require additional resources for training/re-training, and sufficient personnel to ensure decisions can be made on a timely basis so as not to act as an impediment in the system. The regulator would also need to focus energy and resources on the dissemination of regulatory policies and guidelines to assist plan sponsors in the interpretation of the legislated principles and to encourage a culture of compliance. Such policies should not be developed by the regulator in isolation, but rather should be developed in collaboration with affected participants in the pension system, thereby recognizing their role in the voluntary provision of private sector pensions.

In the Panel's view, if it is not appropriate to place the obligation upon the regulator to be responsible for promoting increased pension coverage, the governments will need to look to other structures to achieve that goal. The Panel supports the establishment of the position of a "pension advocate," whose role would be to promote the pension system and the expansion of pension coverage in Alberta and British Columbia. (See also Section 6.5.2 "Joint Pension Advisory Council" below.)

The Panel recommends that:

6.4-A The legislation should be clear that the role of the regulator is to administer and enforce compliance with the legislation, and not to actively promote pension coverage.

6.4-B The regulator's role should focus on risk-based monitoring to encourage and enforce compliance with principles-based standards and prescribed rules.

6.4-C The regulator should be provided with sufficient resources to transition personnel and culture to this new model with appropriate training and education.

6.4-D Regulatory decisions made in a more principles-based system and/or with discretion provided by the legislation should be made with cognizance of the impact of such decisions on pension coverage.

6.4-E The regulator should have discretion under the legislation to consider applications for approval of new plan designs and governance structures applying the principles of general application set out in the legislation and to impose such conditions on registration as may be appropriate in the circumstances and consistent with the principles. (See also Section 6.4.1 "Regulator's tools and checks and balances in the system" below.)

6.4-F The regulator should develop administrative policies and guidelines on a collaborative basis with input from the broader pension community, in order to provide guidance on the

interpretation of the principles-based standards contained in the legislation.

6.4-G The governments should establish the position of a "pension advocate," whose role would be to promote the pension system and the expansion of pension coverage in Alberta and British Columbia. (See also Section 6.5.2 "Joint Pension Advisory Council" below.)

6.4.1 Regulator's tools and checks and balances in the system

Issues

In light of the changes to the role of the regulator recommended in Section 6.4, consideration then needs to be given to what additional tools the regulator might need in order to properly carry out its new role, and to any appropriate checks and balances needed in the system. Questions to be considered include:

- Should the regulator have the ability to impose administrative penalties for non-compliance?
- If the regulator is granted the authority to approve new pension plan designs and impose conditions on registration of specific plans or types of plans, what conditions or limitations should be imposed on the regulator's discretion?
- If such regulator discretion is appropriate, through what legal mechanism should that discretion be carried out?
- In light of the role and powers of the regulator and the goal of harmonization between the legislation in Alberta and British Columbia, what other components are necessary in a properly functioning pension regulatory system? Are additional checks and balances needed?

Discussion

Administrative Penalties

Currently, neither the Alberta nor British Columbia superintendent has authority to levy penalties, although the Alberta regulator has the ability to impose additional fees for late filings of annual information returns. In other cases of noncompliance, the only real recourse for the regulators is to cancel a plan's registration, replace the administrator, seek an enforcement order through the courts or go to court to charge the noncompliant party with an offence (which carries a fine levied by the court within the bounds of penalties permitted or required by the statute). These extreme measures are typically inappropriate for noncompliance related to filings and other administrative, but nonetheless important requirements.

In some jurisdictions where the regulator has the ability to impose additional fees for late filings, that power has proved to be an effective tool for encouraging timely filings. On that basis, the suggestion has been made that the ability to impose reasonable financial penalties is a necessary tool in a risk-based regulatory environment in order to encourage plan compliance and save regulator time.

The power to impose such administrative penalties does exist for regulators of several other financial services in Alberta and British Columbia. However, there is an important concern over who properly bears the incidence of any financial penalties or fees that may be imposed under pension law – the plan or the administrator. Under the other statutes, the registered and regulated party is generally the person who has direct obligations under the legislation (e.g. the insurance agent, the securities issuer, the investment dealer, etc). This could be a reason pension standards legislation has not imposed additional fees to date: the burden of these fees may fall on plan beneficiaries in some cases (such as multi-employer plans), even though they result from the noncompliance of administrators.

While the ability to impose additional fees has been a useful regulatory tool in some jurisdictions, a broader authority to impose administrative penalties may be helpful to deal with other instances of noncompliance, such as noncompliance with a regulator's requests for additional plan information. To address the concern as to who should properly bear the burden, administrative penalties could be designed to be imposed directly on noncompliant administrators rather than plans.

Rule-making authority versus regulatory discretion

A regulatory framework is generally comprised of legislation, regulations and often, policy guidelines from the regulator. Whereas regulators' policy guidelines do not usually have the force of law, in some circumstances, an agency, board or commission established to undertake a regulatory function under the legislation may also have the authority to make legally enforceable "rules." This latter ability of regulators to make rules having the force and effect of regulations is commonly referred to as "rule-making authority."

In its *Report on CAPSA's Work on Regulatory Principles for a Model Pension Law (2008)*, CAPSA recommends that regulators be given the authority to make legally enforceable rules governing matters under the legislation that are of a technical or administrative nature. The process for rule-making recommended by CAPSA is similar to that required for rules made under various Canadian securities statutes, including requirements to publish each proposed rule, a prescribed consultation period and ministerial approval.

Neither the PBSA nor the EPPA currently confers formal "rule-making authority" on the superintendents. However, other existing provisions either delegate, or allow for the governments to delegate in the future, similar discretion to the regulators – using different legal mechanisms.

In both Alberta and British Columbia, the superintendents have the authority to issue directions for compliance with the statute and/or regulations. In Alberta, these directions can more broadly require a party to comply with "safe and sound pension practices" and in British Columbia "to perform such acts as, in the opinion of the superintendent are necessary to remedy the situation."

In Sections 6.2 and 6.3 of this report, the Panel has recommended that pension standards should be flexible enough to allow for new plan designs and other market innovations without requiring time-consuming legislative changes and that a legislative framework comprised of broad principles rather than detailed rules may be the way to achieve this flexibility. However, even within a principles-based legislative framework, it is recognized that more detail may be necessary to provide guidance in some areas, such as time-related requirements, complex calculations, technical specifications or new market developments.

Generally, stakeholders who support a flexible legislative framework that would accommodate future plan designs are also in favour of giving the regulator authority to approve new plan models not specifically contemplated in the legislation. This would facilitate positive innovations in plan design, while continuing to protect beneficiaries from risks identified by the regulator.

Along with the authority to approve new plan designs, it has been suggested that the regulator be provided with additional "tools" to ensure appropriate regulatory protections are in place for innovative plan models. It has been suggested that ongoing discretion to approve new plan designs be accompanied by other regulatory tools:

- discretion to impose conditions on specific plans approved for registration
- discretion to impose additional requirements, or guidelines, that would be applicable to plan models with certain characteristics

Proponents recommend that such regulatory discretion would improve the pension system by streamlining approval processes, fostering innovation and avoiding the lengthy delays normally associated with legislative amendments.

Checks and Balances

The main argument against providing the regulators with these discretionary powers is the risk of insufficient government oversight of regulator decisions, potentially leading to:

- over-regulation and/or inconsistencies with general government policy;
- lack of harmonization between jurisdictions (even with ostensibly harmonized legislation);

- lack of transparency in the absence of explicit rules allowing the regulated entities to see what standards are being applied to them; and
- lack of consistency or even-handedness as between cases.

The risks described above should not be underestimated – but they are also not necessarily implicit in the grant of discretionary powers. Overzealous regulatory responses may be mitigated by limiting discretion to specific topics, requiring consultation, requiring ministerial approval or subjecting the exercise of the discretion to appeal or other oversight. On the other hand, care must also be taken to ensure that the original objective – a streamlined regulatory approval process – is not defeated by the imposition of too many restrictions. Where it is determined that more government oversight is required, conferring discretion on the regulator should likely be reconsidered.

Several stakeholders suggested that the legislation should include a requirement for periodic reviews of pension standards, one suggested re-establishing the Pension Advisory Council in British Columbia (similar to Alberta's existing advisory committees), and a number advocated the establishment of a "pension ombudsman" (or providing the regulator with authority to act in this capacity). One submitter also advocated the creation of a joint Alberta/British Columbia tribunal to hear appeals of regulatory decisions, and also advocated providing the industry with more time to provide input on proposed legislative changes.

"Rule-making authority" – or something else?

Deciding which legal mechanism should be used to make laws depends on a number of criteria. Consideration must be given to the nature of the provision, whether there are significant public policy considerations involved, whether the provision would impact the personal rights of individuals, whether implementation is urgent, whether there is sufficient authority in the legislation for the government or someone else to make rules on that topic, and whether the regulator is independent from government.

Where, as recommended by the Panel, providing the regulators with an authority to approve new plan designs is determined to be appropriate, this authority should likely be provided in the legislation. Currently, the superintendents are obligated to register plans unless they do not comply with the legislation and the regulations. A legislative amendment would be required to allow the superintendent to approve a new plan design that is not contemplated in the current legislative framework.

If conferring discretion on the regulators to impose conditions on specific plan registrations is considered appropriate, this may be done by regulation, assuming legislative authority exists for the governments to make this type of regulation. As mentioned above, under current Alberta and British Columbia statutory provisions, both superintendents currently have this power.

If it is determined that delegating discretion to the regulators to set out requirements that would apply generally to plan models with certain common elements is appropriate, this may also be done by regulation assuming there is sufficient legislative authority for the governments to confer this type of discretion. Therefore, discretion in any of those matters could be delegated by the governments to the superintendents under the legislation.

In both Alberta and British Columbia, the Superintendents of Pensions are employees of the government, performing their duties within the finance ministries. Where government engages in regulation directly, subsidiary legislation is typically implemented through regulations rather than rules. The Panel is not aware of any example of formal rule-making authority being available to government employees or Ministers of the Crown. While it would be very unusual to confer formal rule-making authority on a government employee, it would not be unusual, through other legal mechanisms, to confer discretion to approve new products, impose conditions on specific regulated entities or set guidelines applicable generally to certain types of regulated entities.

Panel Perspectives and Recommendations

In the context of a more flexible, principles-based system involving risk-based regulatory supervision, such as is being recommended in this report, the Panel believes that it is appropriate for the regulator to possess the power to impose administrative penalties. Such penalties should not be mandatory for any instance of non-compliance, but rather should be available to be used by the regulator in a measured manner to encourage compliance and discourage non-compliance. Without such penalties, the regulator's existing statutory powers are insufficient other than in the most egregious of situations and do not produce an appropriate result.

The most common form of administrative penalty should be the imposition of fines. However, fines may not be the most appropriate way to deal with a particular situation. Other forms of penalty powers, such as the ability to freeze assets or to order disclosure of material information to plan members and retirees, may well be more effective in addressing certain problems.

The Panel recommends that:

6.4.1-A The regulator should have the power to impose administrative penalties, subject to the following conditions:

- **Penalties should only be imposed with proper advance notification in writing that the penalty is intended to be applied and providing a reasonable opportunity for the matter at issue to be "cured" before the penalty is imposed.**
- **The penalties could be imposed for failure to:**
  - **file annual information returns on time;**
  - **file valuation reports on time;**

- **file annual financial statements on time;**
- **respond to superintendent requests for information on time;**
- **disclose information to members on time; or**
- **make contributions on time.**

- **Proceeds of fines should be used to finance the regulatory system and should not be directed to the governments' general revenues.**
- **The authority to impose penalties should be discretionary depending on the circumstances for significant issues of non-compliance or to encourage appropriate plan management/governance, and not as punishment other than in egregious situations.**
- **Penalties should be imposed on the party responsible for the matter or action at issue, typically the plan administrator, and should not be charged to or be payable from the plan.**
- **The imposition of the penalty should be subject to appeal. (See also Section 6.5.1 "Joint Pension Tribunal" below.)**

The Panel does not, however, believe it is necessary for the regulator to have explicit legislative rule-making powers. The more the legislation is cast in the form of broad principles, coupled with the regulator's existing authority to administer the legislation, the less "exceptional" authority is needed. If the purpose is to create flexibility in the regulatory system, a power to generate rules is not only unneeded, it may be undesirable and would be contrary to the intent of creating a more principles-based regime.

The Panel is of the view, as discussed in brief in Section 6.4, that the regulator should be granted the discretionary authority to approve new plan designs and associated governance structures under a more flexible legislative regime. Employing a more principles-based approach to the legislation, as the Panel has endorsed in Section 6.2, requires that the regulator have broad ability to consider the application of those principles to any proposed plan design. Otherwise, there could be no certainty that the design was in compliance with the legislated standards. In doing so, it may be necessary to impose conditions on any such approval so as to ensure that the plan remains in compliance with the principles-based standards.

If a new plan design becomes popular, or a number of similar but not identical designs are developed, the regulator should also have the ability to create guidelines of general application to such plans possessing common features. Issuance of such guidelines would increase certainty and serve to avoid similar plans being treated differently. However, in light of the policy element necessarily involved in the creation of such guidelines, the Panel endorses the concept of the creation of a policy advisory body to assist the regulators and provide broader input from the pension community regarding the implications of the guidelines.

The Panel recommends that:

6.4.1-B The regulators should be provided with discretion to approve new plan designs and associated governance structures in the following manner:

- **The process for approval of new plan designs should be set out in the legislation.**
- **The legislation should provide the superintendents with the discretion to make guidelines of general application to plans with certain common design features.**
- **Where the regulator intends to impose conditions of general application for a new type of plan in connection with specific features that are not contemplated in the legislation, consultation with a policy advisory body (to be established by the governments) should be required. In publishing such guidelines, the regulator should identify the particular elements that make the new model different and justify the creation of the guidelines. (See also Section 6.5.2 "Joint Pension Advisory Council" below.)**
- **Regulators' decisions on plan approvals should be subject to appeal. (See also Section 6.5.1 "Joint Pension Tribunal" below.)**
- **The legislation should prescribe considerations or conditions that the regulator must take into account in exercising the decision-making discretion.**
- **In order to encourage and maintain consistency between the two provinces, consultation between the regulators in Alberta and British Columbia should be mandated as a matter of policy of the two governments prior to the issuance of any approval or rejection of a new plan design, or the publication of a guideline of general application. (See also Section 6.5 "Harmonization" and Section 6.5.3 "Joint pension regulator" below.)**

The Panel firmly believes that the expansion of regulatory discretion, in the manner contemplated above, is an important and necessary element of a revised pension system. However, disputes regarding the exercise of that discretion are inevitable where flexible, principles-based standards and the imposition of financial and other penalties are involved. In order to enhance the fairness in the system and provide regulated persons with access to fundamental justice in an open and transparent manner, the Panel believes that certain new organizational structures should be created to act as checks and balances with respect to the exercise of regulatory discretion, and to provide input to the regulators where such discretion would be exercised with broad application. Such structures can also assist with the ongoing harmonization of standards between Alberta and British Columbia, as further discussed below. (See Section 6.5 "Harmonization" below.)

The creation of an independent appeal tribunal comprised of experts in the pension field would provide a lower cost, more effective, more accessible dispute resolution process than is presently available through the courts (being the only method currently available in Alberta). With enhanced discretionary powers in the regulator, and in particular the ability to impose administrative penalties, it is likely that the exercise of that discretion would result in more disputes. Today, those affected by the decisions of the regulator, particularly in Alberta, must pursue recourse through the courts, which is a costly and time-consuming process and has likely had an adverse impact on the willingness of parties to dispute regulatory decisions. With appropriate application of standards of review by a tribunal, the exercise of regulatory discretion would be more open and transparent and would likely improve over the course of time. Perhaps most importantly, those impacted by such decisions would have enhanced access to justice.

The Panel's strong recommendation is that such a tribunal be constituted on a joint basis between Alberta and British Columbia, with jurisdiction to hear appeals arising in both provinces. At a minimum, if it cannot be jointly constituted, Alberta should establish a tribunal within its jurisdiction, and changes should be made to the existing British Columbia Financial Services Tribunal to ensure it will be seen by courts as an expert tribunal in the area of pension matters and, therefore, be more likely to show its decisions the desired deference. (See also Section 6.5.1 "Joint Pension Tribunal" below.)

The Panel also supports the establishment of a joint policy advisory committee between the two provinces. The resources and skill sets of the regulator, and of the governments themselves, are limited in comparison to the complexity of pension issues. The governments and regulators could benefit from regular input from a wide array of individuals involved in the pension system in setting policy direction and understanding the implications of policy and regulatory decisions on the pension system. If, as has been recommended, the regulator is not responsible for the promotion of pension coverage, that role needs to be housed somewhere and has obvious synergies with a body constituted to provide pension industry insight and policy advice to the governments.

The Panel recommends that:

6.4.1-C The governments should each establish an independent expert administrative tribunal, preferably on a joint basis, to hear appeals from superintendents' decisions. Such a tribunal should be authorized to hear appeals from any decision of the regulator by a party to the issue at hand. (See also Section 6.5.1 "Joint Pension Tribunal" below.)

6.4.1-D The governments should establish a joint policy advisory council to provide broad input and insight to the ministers responsible for pension standards in the two provinces and to the regulators, in respect of matters of pension policy and compliance on an ongoing basis. (See also Section 6.5.2 "Joint Pension Advisory Council" below.)

6.4.2 Financing the regulatory system

Issues

Recommendations contained in this report for changes to pension standards legislation and to the related regulatory system and structures necessarily have cost implications. In considering those recommendations, along with the functioning of the pension regulatory system generally, the question must be asked:

- Who should pay for the cost of regulating the pension system?

Discussion

Currently, both Alberta and British Columbia charge pension plans annual fees as a way of covering the cost of regulating the pension system. In Alberta these fees are calculated to cover the direct cost of providing the regulation (for example, salaries of staff members and computers) but not some of the indirect costs (for example, technology support, power and centralized functions). In British Columbia, regulatory and policy operations are physically and financially separate. Direct and indirect costs associated with policy functions are predominantly paid for from general tax revenues, while the costs of the regulatory function are financed by regulatory fees. Thus, both Alberta and British Columbia effectively have a hybrid system where the costs of regulation are borne by both users and taxpayers.

Those in favour of funding the regulatory system through tax revenue have several reasons for their position. First, from the point of view of pension plan sponsors, such fees may be a disincentive to offering plans at all. Second, from the point of view of pension plan members, such fees may be viewed as diminishing the amount of funds available to retirees; that is, those of this view worry that employers will decrease funding to offset the cost of fees. Third, from the point of view of society as a whole, there is a social benefit in ensuring pension plans are properly run so as to provide income for retirees and lessen dependence on public assistance.

Those in favour of a user-pay system see the fees charged as not significant and therefore not barriers to plan adoption by employers. Moreover, they argue that those who stand to gain the most benefit from well-run plans should bear the cost of regulation. They also take the view that users of the system have more "ownership" of service standards and can demand accountability.

A hybrid system would seek to address concerns on both sides.

If a user-pay system is to be adopted, there are several ways that fees could be levied (keeping in mind that the Supreme Court of Canada's decision in *Re Eurig Estate*[26] suggests any fee structure imposed must be related to the actual cost of providing the service). The first option is that currently in use in Alberta where a flat fee is charged per member within a minimum and maximum range. The second is British Columbia's slight variation on this system whereby active members are differentiated from former members.

Additionally, it is possible to make further refinements in an effort to assign a cost to pension plans that reflects the amount of regulatory effort that was put in. Differential fees could be charged for plans that are more complicated to regulate. Another option would be to charge higher fees for those plans deemed to be higher risk and require more regulatory attention.

Stakeholders who made submissions to the Panel were split between those in favour of the regulatory system being financed by the government through general tax revenue and those in favour of a system of user pay, largely on the bases discussed above. Of those

favouring user pay, that support was often conditional: stakeholders would "not object" to such a system so long as the system met certain requirements, including:

- The regulator should be accountable for expenditure of fees paid by plans.
- User fees should be tied directly to the cost of providing the regulation and should not be used to subsidize other operations; put another way, fees should be on a cost recovery basis and be related to the amount of regulation required.
- Regulators should develop a verifiable calculations of the costs of activities delivered in the system, to accurately determine costs to be recovered through user fees.
- Regulation costs should be minimized by not collecting superfluous information or through the simplification of legislation.

Panel Perspectives and Recommendations

In general, the Panel's view is that the costs of the pension system as a whole should be shared. That is, the system should be neither fully taxpayer-funded (since pensions are voluntary compensation programs established to benefit the employer and employees) nor fully user-paid (since pensions provide a societal benefit by assisting in providing retirement incomes, thereby reducing reliance on social programs). A full "user-pay" model would not recognize the benefit to society of sponsors providing plans, and a "no fees" model does not recognize the market-based, competitive compensation aspect and benefits to sponsors and members.

[26] [1998] 2 S.C.R. 565

Industry appears willing to continue to pay, or perhaps even to pay more, for a more flexible and responsive regulatory system. However, the Panel believes that the social policy aspect of pension policy must also be recognized. A solely user-pay system is not as appropriate for pensions as it is, for example, for securities regulation which is squarely in the financial interest of those people paying for that system. It appears to the Panel that there is a balance that can be drawn between these viewpoints that can act to encourage plans, but also manage the costs of regulation.

The Panel recommends that:

6.4.2-A The pension regulatory system should be funded on the following bases:

- **The policy aspects of pension regulation are social policy, with the purpose of reducing future dependence on the public purse, and therefore should be funded by general revenues.**
- **Direct regulatory activities are related primarily to ensuring that the "pension deal" struck by the parties is delivered, and therefore should be funded by user fees.**

6.5 Harmonization

Issues

Harmonization of pension standards legislation, or the lack of it, is a topic of much discussion in the pension community. Within the scope of the Panel's review, a number of related issues are relevant for consideration:

- Is harmonization of pension standards a desirable goal? Are there costs associated with lack of harmonization?
- To what extent should Alberta and British Columbia attempt to harmonize their respective pension standards legislation?
- What specific standards should be harmonized?
- If Alberta and British Columbia pension standards are harmonized, how can harmonization be maintained in the future?
- Is national harmonization desirable? How can Alberta/British Columbia harmonization contribute to harmonization with other Canadian jurisdictions?

Discussion

While the nature of Canada's constitutional arrangement virtually guarantees diversity among provincial laws, there have long been calls for greater uniformity of financial sector standards between jurisdictions. Literal uniformity of laws across provinces is very difficult (though not impossible) given local conventions of drafting and the need for jurisdictions to ensure consistency between the law and the larger legal context in which it must operate.

Due to the challenges of achieving word-for-word uniformity, the concept of "harmonizing" legislation has emerged. Harmonization can be defined as the process of "making the regulatory requirements or governmental policies of different jurisdictions identical, or at least more similar."[27] Harmonization may involve the development of laws in different jurisdictions that are highly similar in terms of basic principles but not detailed provisions, or may involve a high degree of similarity between detailed regulatory requirements.

The basic objectives of harmonization are to allow those who must comply with the laws of several jurisdictions to do so without undue difficulty and expense, and to ensure that those familiar with the law in one jurisdiction can easily understand the law of another and adjust to it without difficulty.

Regulation of multi-jurisdictional pension plans

There are ten pension jurisdictions in Canada. Each province has legislation governing occupational pension plans within its jurisdiction (Prince Edward Island has yet to proclaim its statute). There is also federal legislation governing pension plans established in federally-regulated industries and the territories.

Statistics Canada figures indicate that about 20 percent of all private sector pension plans have members in more than one province. Approximately 1.5 million members, 26 percent of all plan members, are covered by these multi-jurisdictional pension plans (MJPPs). MJPPs tend to be larger and more complex than other pension plans. Many MJPPs have members in five or more provinces, requiring the plans to comply with numerous legislative requirements. In 2007, over 5,000 Alberta workers participated in plans registered in British Columbia, over 87,100 participated in plans registered in Ontario and over 56,600 participated in plans registered federally, while over 9,700 British Columbia workers participated in plans registered in Alberta, over 59,400 participated in plans registered in Ontario and over 76,700 participated in plans registered federally.

Inconsistent laws, overlapping powers and uneven administration of similar laws cause frustration and create unnecessary delay for pension plans with members working in more than one jurisdiction. While there are some areas of uniformity among the different pension standards statutes, there are many significant differences. Divergent laws increase costs and administrative difficulties for these MJPPs.

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[27] D. Leebron. (1996). Claims for Harmonization: A Theoretical Framework. *Canadian Business Law Journal*, *27:* 63-107, at p. 66.

Different legislative requirements also create uncertainty for plan members who move between jurisdictions, and can result in inconsistent treatment of members of the same plan working in different jurisdictions. In the context of MJPPs, harmonization of pension standards is seen as supporting labour mobility, simplifying disclosure and reducing administrative costs for plan sponsors.[28]

The suggestion has been made that the simplest way to deal with MJPPs would be for the provinces to simply turn jurisdiction over the regulation of such plans to the federal government and its pension regulator. While that idea may have some appeal, the likelihood of provincial governments ceding their jurisdiction over industries and individuals' rights within the scope of their constitutional authority is difficult to envision.

Even if harmonization of pension standards between Alberta and British Columbia can be achieved, another challenge will be how to maintain harmonization over time.

1968 Memorandum of Reciprocal Agreement

The provinces have entered into reciprocal agreements with each other and with the federal government in order to ease the burden on plan administrators and avoid duplication of government regulatory functions. The authority to enter into such agreements is conferred under pension legislation in each jurisdiction. However, jurisprudence relating to MJPPs has highlighted the need to revise and update these arrangements.

The 1968 Memorandum of Reciprocal Agreement (MRA), an arrangement that over time has been joined by all the provinces except Prince Edward Island, provides the basis for the current regulatory framework for multi-jurisdictional plans. Most of the provinces have similar bi-lateral agreements with the federal government. When the MRA was executed, pension standards statutes were substantially similar among the jurisdictions.

Under the MRA, the regulatory authority in the province where the plurality of members are employed acts as the "major" supervisory authority and the one in which the plan is registered. The MRA allows the delegation of responsibility to the "major" regulatory authority for the enforcement of pension legislation by each "minor" jurisdiction (any other jurisdiction where plan members may be located). The arrangement allows MJPPs to be registered in only one province – the major authority – while remaining subject to the laws of each jurisdiction in which they have plan members.

While the object of the MRA is to simplify plan administration, the application of the existing agreement has created a number of challenges for regulatory authorities:

[28] CAPSA (2004). Proposed principles for a model pension law.

- Differences between pension statutes across Canada make it impractical, if not impossible, to simultaneously apply the rules of several jurisdictions to matters affecting the plan as a whole.
- The MRA does not provide guidance on which rules should apply where a matter is not contemplated in the existing pension legislation (such as allocating assets among jurisdictions upon the termination or split of a MJPP).
- It does not provide guidance as to how benefits are determined when an employee has earned credits in multiple jurisdictions, which has led to the use of "checkerboarding" in Ontario as opposed to a "final location" treatment in other provinces. Checkerboarding means that pension credits earned in a particular jurisdiction are always subject to the laws of that jurisdiction, while "final location" applies the laws of the last jurisdiction worked in by the employee. Using checkerboarding, when an employee terminates employment, his or her benefit entitlement is determined by a complicated process of applying the laws of each jurisdiction to the pension credits accrued in that jurisdiction.

Because of the difficulties in applying the MRA in its current form, current regulatory practice across all MRA signatories is to determine procedural and administrative matters in accordance with the law of the province of registration and member entitlements according to the law in each member's province of employment.

Current regulatory practice with respect to the regulation of MJPPs was brought into question by the Ontario Divisional Court's decision in *Leco*,[29] which highlighted the lack of legal authority under the current MRA to regulate in this way. Since the *Leco* decision, Canadian pension regulators have been more cautious in their approach to the administration of reciprocal agreements with other jurisdictions, administering according to each jurisdiction's rule where there is a possibility of inconsistency, and consulting with the relevant jurisdictions if there is any doubt.

CAPSA has proposed a two-pronged approach for harmonizing Canadian pension legislation and streamlining the regulation of MJPPs:

- Revise the MRA so that it is possible and practical to implement.
- Develop principles for common pension standards as the basis for harmonized pension standards legislation in Canadian pension jurisdictions.

A new reciprocal agreement, reflecting current regulatory practice and addressing gaps in the MRA, is under development by CAPSA. A proposed agreement was released by CAPSA for comment on October 21, 2008, which reflects current practices for regulating MJPPs and would (among other matters):

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[29] Régie des rentes du Québec v. Pension Commission of Ontario, 189 D.L.R. (4th) 304, [2000] O.J. No. 2845 (QL). (Ont. Div. Ct.).

- establish rules for the determination and change of a plan's "major authority";
- allow the laws in the jurisdiction of registration to apply to plan matters, such as funding, investment and plan registration, and the laws in the jurisdiction where the member is employed to apply to benefit entitlements, including vesting, locking-in and surplus distribution in relation to those members;
- use the "final location" approach for the determination of pension entitlements; and
- provide clear rules for the allocation of assets between jurisdictions in the event of a plan wind-up or split.

Arguments in the harmonization debate

The argument made most frequently by stakeholders in favour of harmonization is based upon considerations of business efficiency. Proponents of harmonization contend that, while high costs and administrative complexities may deter the establishment or continuance of MJPPs, harmonization may ease the regulatory burden on plan sponsors and help to increase pension coverage.

Another argument in favour of harmonization is that it encourages equitable treatment of plan members working in different jurisdictions. Currently, members of the same plan working in different jurisdictions may receive inconsistent treatment because of differences in pension standards. While some diversity of laws among jurisdictions results from a need to address regional conditions, there are many examples of standards where there is no apparent difference in local conditions that would justify the difference (for example, the definition of "spouse" or its equivalents). It has been argued that differences between laws that are not founded on reason bring the law into disrepute.[30]

Diversity of pension standards also inhibits the development of jurisprudence and creates uncertainty about the authority of decisions made by courts in other jurisdictions where similar legislative schemes have been considered. Harmonization could lead to greater legal certainty and the development of a more coherent jurisprudence. However, even where pension statutes are harmonized, the possibility remains for courts in different jurisdictions to produce inconsistent legislative interpretations, creating differences in legal effect and treatment.

Some stakeholders have expressed concern about the potential for harmonization to result in a "race to the bottom," a process through which governments are said to dismantle regulatory standards to increase their competitive advantage. The fear is that harmonization will involve the selection of the least stringent pension standards, thereby resulting in "lowest common denominator" standards.

[30] Hulburt, W.H. (1986). Harmonization of provincial legislation in Canada: An elusive goal. *Canadian Business Law Journal*, 12: 387-424.

However, the approach taken by CAPSA in the development of its principles for common pension standards suggests that harmonization need not result in the adoption of the lowest common denominator. CAPSA, with input from pension stakeholders, has developed principles that reflect "best practices" in pension regulation and governance. There is nothing to suggest that the harmonization process must take the form of "downward leveling."

There is also a concern that harmonization severs the connection between the electorate and decision-makers. Canada's system of parliamentary democracy requires decisions to be made by elected representatives. Furthermore, under the Canadian constitution, laws affecting property and civil rights within the province are to be made by the provincial legislature. Some say that the harmonization of laws will inevitably result in the acceptance by some provincial legislatures of decisions made outside of the legislature. However, this is not necessarily implicit – in a perfect harmonization scenario, each legislature would only agree to adopt laws of other jurisdictions in circumstances where appropriate consultation, analysis and collaboration had been involved.

Another argument against uniformity of legislation between jurisdictions – or "automatic" harmonization – is the loss of opportunities for innovation. Having multiple pension jurisdictions allows new laws to be tested in a single jurisdiction and, once proven to be an improvement upon existing law, they can be adopted in other Canadian jurisdictions. Such innovation could be threatened if universal harmonization existed.

A review of the stakeholder submissions received by the Panel shows broad support for the harmonization of pension standards legislation between Alberta and British Columbia. Many submitters also expressed support for national harmonization, and some suggested that a national pension regulator be created. There were, however, reservations expressed about the feasibility of achieving national harmonization. Several submitters suggested that although harmonization is an important objective, it should not stand in the way of necessary reforms. A small minority of submitters did not support harmonization, on the basis of the "race to the bottom" concern.

Panel Perspectives and Recommendations

The Panel believes that harmonization of pension standards in Alberta and British Columbia would simplify regulatory requirements for MJPPs, thereby facilitating labour mobility and contributing to the competitiveness of the provincial economies compared to other jurisdictions. Harmonization would be of significant benefit to plans that operate with members in both provinces, to reduce unnecessary administrative cost and burden that frustrate sponsors and create artificial differences that can lead to inconsistency and potentially inequity between members. Harmonization of pension standards would also allow providers of savings and retirement-income vehicles to create economies of scale, increasing availability and competitiveness of products in the two provinces. The Panel does not foresee any legal or practical impediments which would prevent the statutes from being fully harmonized, resulting in identical statutes in the two provinces.

Concerns about harmonization resulting in a "race to the bottom" may be eased where the goal of the harmonization process is to select the *most appropriate standards* for achieving the stated objectives of the legislation. The development of appropriate standards may involve selecting either Alberta's or British Columbia's approach, developing a new or improved provision, or eliminating unnecessary requirements. (See also Section 9.2, "Standards requiring harmonization and standards perceived as 'irritants'" below.)

If there is to be any hope for broader harmonization on a national level in Canada, the process must start somewhere. The very nature of the joint review process which led to the creation of the Panel is indicative of the willingness of the governments to explore this opportunity and to take a leadership position in the promotion of harmonized pension standards across the country.

The Panel recommends that:

6.5-A The governments work together to fully harmonize pension standards legislation in Alberta and British Columbia, resulting in identical statutes with the same name in the two provinces.

6.5-B It should be made clear that the harmonization effort is not designed to produce lowest common denominator legislation or result in a "race to the bottom", but rather that the most appropriate standard in each instance would be adopted.

6.5-C The rule of "final location" should be confirmed in Alberta's and British Columbia's pension standards legislation to ensure that the laws of the jurisdiction in which a plan member worked last apply to that person's benefits, regardless of where the pension credits were actually earned.

While it may be possible to create a harmonized or even uniform statute in Alberta and British Columbia in the first instance, in the Panel's view the greater challenge will be how to maintain harmonization on an ongoing basis. It has been argued that unless institutions are also harmonized, differences in implementation and effect will arise over the course of time. In the absence of organizational structures designed to maintain harmonized legislation and regulation, it is likely that pension standards will again diverge, as they have over the past 15 years in Alberta and British Columbia notwithstanding that the legislation was virtually identical when adopted.

The Panel believes that the governments must take steps today to establish structures that will both promote harmonization going forward and discourage future governments in the two provinces from undoing what has been accomplished. The Panel recognizes that it is not possible to bind the hands of future governments, and that political considerations in the future may well lead to divergence. However, to the extent that principled steps are taken today with a view to ongoing harmonization, it will require any future government to actively turn its mind to undoing the harmonization that exists.

The Panel supports the creation of three organizational approaches to maintain continuous harmonization: a Joint Pensions Tribunal (JPT), a Joint Pensions Advisory Council (JPAC) and a joint pension regulator for pensions in the two provinces. These structures are discussed further in Sections 6.5.1 through 6.5.3. The JPAC and JPT have been discussed above in the context of checks and balances in the regulatory system. A role in harmonization gives such bodies dual and equally important purposes, thereby providing additional justification to support their creation. A single joint regulator would facilitate consistent interpretation and application of harmonized legislative provisions.

The Panel recommends that:

6.5-D The governments should work together to create joint organizational structures that would foster continued harmonization of pension standards legislation in the two provinces, including a Joint Pensions Tribunal, a Joint Pensions Advisory Council and a joint pension regulator. (See also Sections 6.5.1 through 6.5.3 below.)

Harmonization between Alberta and British Columbia could provide a model for wider harmonization throughout Canada. The large numbers of workers across the country participating in plans registered in other jurisdictions is indicative of the need for the broadening of harmonization efforts. CAPSA's efforts to develop common pension standards have already gone a long way to promoting harmonized pension statutes. The work undertaken by CAPSA to date towards development of model law principles around "non-controversial" aspects of pension standards (often referred to as the "70 percent solution", referring to the view that 70 percent of the standards fall into this category) has proven beneficial and should continue. While there is always the possibility that the approach taken by Alberta and British Columbia would not be accepted by all other jurisdictions, to the extent that it is consistent with CAPSA's principles, it is more likely to find favour in the Canadian pension community.

The Panel is conscious of the work also currently underway by the Ontario Expert Commission on Pensions and the Nova Scotia Pension Review Panel. The existence of three legislative review bodies in the country at the same time signals that the modernization of pension standards is on the national agenda. Significant opportunity exists today for further national dialogue around the findings and recommendations of these bodies.

While a single national statute may not prove to be practical, efforts focused on uniform or harmonized legislation, patterned on the approach taken in Alberta and British Columbia (including identical legislation adopted in each province, with mechanisms established to ensure ongoing harmonization of legislation and interpretation) or in combination with other innovative ideas emerging from Ontario, Nova Scotia or elsewhere, should be pursued.

One practical impediment to such efforts historically has been the fact that pension standards are dealt with in different ministries in different provinces, reducing opportunities for the Ministers responsible for pension standards to meet to discuss harmonization issues. However the benefits to harmonization in Alberta and British Columbia apply equally beyond the borders of the two provinces. The Panel supports recent calls for a coordinated approach to national harmonization of pension standards, including the convening of a summit of responsible ministers as soon as possible and development of a process to take the issues forward thereafter.

The Panel recommends that:

6.5-E National harmonization initiatives should be pursued by the governments, starting with the establishment of a national council of ministers responsible for pensions as soon as practicable, to consider:

- **the viability of harmonized or uniform pension standards legislation across the country;**
- **if national harmonization were to occur, the viability of a single national pension regulator;**
- **promotion of the rule of "final location" across the country; and**
- **continued work towards the "70 percent solution" through the CAPSA Model Law efforts in respect of "non-controversial issues" in the short term.**

6.5.1 Joint Pension Tribunal

Issues

- Should a joint pension tribunal become part of a new harmonized legislative regime in the two provinces?
- What would be its composition?
- What matters would be within its mandate to decide?
- What powers would it have related to:
    - the conduct of its affairs;
    - superintendent decisions; and
    - enforcement?

Discussion

The policy rationale for creating a pensions tribunal is to provide those that are subject to the superintendent's authority an opportunity to have adverse decisions reviewed by an independent party without, or before, going to the courts.

Currently, three provinces, British Columbia, Quebec and Ontario, have independent tribunals that hear pension appeals. The other provinces, including Alberta, rely on the courts to hear appeals of regulator decisions.

The main benefits of expert tribunals are generally that:

- they provide a relatively inexpensive and streamlined avenue of recourse against unfavourable regulator decisions without the need to go to court; and
- they can be resourced with specific subject matter expertise resulting in informed decisions and building precedents in a very technical area.

The main arguments against the establishment of an expert tribunal are:

- cost; and
- potential conflicts of interest.

Although an independent tribunal with specialized technical expertise in complex subject matter may be an ideal element of the regulatory framework, the cost of establishing and maintaining such a body may be difficult to justify for a very small number of potential appeals. On the other hand, it is possible to mitigate excessive costs for a tribunal that does not hear a large volume of appeals by leveraging administrative resources of existing registries and tribunals and by charging appropriate fees for filing an appeal. Of course, as discussed above, in a more principles-based regime, with increased regulatory discretion to approve new plan designs and the regulator having the power to impose administrative penalties, it is conceivable that the number of potential appeals of decisions of the regulator could increase substantially.

The potential for conflicts of interest may be considered a risk for an expert tribunal if the number of experts on the particular subject matter is small. With a narrow field of experts, there is a higher potential that they may have conflicts or perceived conflicts on any particular case. This characteristic of expert tribunals has been recognized by the Supreme Court of Canada which has ruled that the general principles of procedural fairness with respect to independence and conflict may not be appropriate for specialized tribunals. In cases where specialized technical knowledge is required, the requirement for expertise in the area of enquiry may override other common law principles. It is for this reason that legislatures do have the power to enact legislation that modifies common law fairness requirements and that some conflicts of interest may be tolerated, even though they would not be permitted under traditional common law principles of procedural fairness.

The policy objective of establishing a joint tribunal for British Columbia and Alberta is to improve consistency and efficiency in the adjudication of harmonized pension standards in the two jurisdictions. As has been noted above, even uniform legislation may not be harmonized in practice if it is interpreted and applied differently by two regulators. A JPT could be a mechanism for ensuring the consistent interpretation and application of harmonized provisions. A JPT would also have access to pension experts from both provinces, mitigating concerns that there may not be enough experts available to resource a specialized pension tribunal, and reducing the risk that a panel could not be struck because of a shortage of non-conflicted panel members.

There is no ready example of an existing multijurisdictional tribunal similar to that being proposed, although it is noteworthy that a joint (interprovincial) pan-Canadian tribunal is currently under consideration for securities regulation. In its 2006 recommendations to the federal government, the Crawford Panel on a Single Canadian Securities Regulator suggested that an inter-provincial securities tribunal could work, but did not address details.[31]

Administrative Law

How a tribunal exercises its jurisdiction or the authority it receives from government is governed by administrative law. If a JPT were to be established, it would be important to ascertain that it could effectively exercise its powers and withstand any foreseeable challenge to its jurisdiction. There appears to be no overarching constitutional or procedural impediment to the effective operation of an interprovincial JPT.

Where a JPT's decisions are unfavourable, the appellant may still appeal to courts, although the courts' jurisdiction may be limited depending on the expertise on the tribunal, whether a privative clause exists and if so, how it is worded. A privative clause is a provision contained in legislation that is designed to fully or partially limit judicial review of an administrative tribunal's decisions. An example of such a clause is contained in subsection 242.3(2) of British Columbia's *Financial Institutions Act* relating to decisions of the British Columbia Financial Institutions Tribunal (FST): "A decision of the tribunal on a matter in respect of which the tribunal has exclusive jurisdiction is final and conclusive and is not open to question or review in any court."

Governance

As a fundamental principle, the JPT needs to be independent from the superintendents, and accountable to the ministers or the governments. Accountability starts with the appointment process – members would be appointed by government under the rules applicable to the appointment of administrative tribunals in the province of appointment.

[31] *Blueprint for a Canadian Securities Commission* – June 7, 2006 – Crawford Panel on a Single Securities Regulator.

As a public body, the JPT would likely be required to report annually to the responsible ministers.

Common members (CM) model

A joint tribunal model that has been considered for the securities industry, the "common members model," contains elements that could be applicable in the pensions context:

- Each jurisdiction would enact harmonized tribunal legislation which would create an individual tribunal and provide all the legal mechanisms for appointments, administration, funding and accountability.
- The harmonized legislation would include rules of procedure for each tribunal.
- A memorandum of understanding (MOU) between the two provinces would provide that members would be cross-appointed to the tribunals in both jurisdictions, so that they would be, simultaneously, members of each tribunal (common members).
- Appeals from superintendent decisions would be heard in the province of registration under the legislation of that province by joint appointees to the tribunal.

The main risk for a JPT would be a challenge of its jurisdiction to operate extraterritorially. Therefore, in designing the JPT, it would be important to ensure that it cannot be said to be improperly asserting jurisdiction beyond provincial borders. By effectively creating a tribunal in each province, the CM model would be the best approach to withstand jurisdictional challenges.

Appointing members

Under a CM model, members would be appointed by the governments of both jurisdictions. The governments would act in concert, according to terms stipulated by the MOU. The appointment mechanism would include a mechanism to ensure that the membership of the JPT is agreeable to both jurisdictions.

While it is important that there be a sufficient number of members to hear any appeal that may arise in either province in a timely manner, the ideal size of the JPT and the number of members required to form a hearing panel must also be practical in view of the historically low number of appeals of superintendent decisions under the PBSA and the EPPA.

The existence of a privative clause would not give the JPT a "final say" without ensuring that the JPT is appropriately comprised of members with extensive pension knowledge. One of the advantages of making the tribunal joint between the two provinces is the expanded field of available experts. Experts from other provinces could also be considered, subject to practical considerations relating to the cost and feasibility of convening the members. Some of these concerns may be overcome if JPT appeals, like appeals to British Columbia's FST, were limited to appeals based on the written records and written submissions.

Accountability

Under a CM model, the JPT would be accountable to each jurisdiction, though both would agree to subordinate their decisions regarding the appointment and dismissal of members of the JPT to the terms of the MOU.

Budget and funding

Budget and funding issues would be covered in the MOU. A significant portion of the JPT's funding would be handled on a case by case basis by each jurisdiction for its own appeals. As a result of having common members participating in appeals in both provinces to encourage uniformity of decisions and the development of Alberta/British Columbia case law, any expenses incurred may ultimately be shared.

The correct level of funding would depend on the structure of the JPT. The overall cost would also depend on the number of appeals and the level of fees charged for an appeal.

"Clustering" smaller tribunals together can achieve economies that may have otherwise only been available at the expense of independence. In British Columbia, a policy decision (not requiring any legislation) has been made to cluster the FST with a single appeal board registry, with in-house registry staff capable of simultaneously serving several administrative tribunals whose members sit on a part-time basis.

Remuneration and benefits of members and employees

Each jurisdiction would be responsible for setting the working conditions of its tribunal members and personnel. Members of a CM tribunal would hold two positions, one in each province. This could become complicated with the application of different appointee pay guidelines depending on which superintendent's decision is being appealed, but should not be unworkable.

Panel Perspectives and Recommendations

For the reasons noted above, both in respect of appropriate checks and balances on the power of the regulator in a more flexible and principles-based system, and in respect of ongoing consistency in the interpretation and application of harmonized legislation, the Panel supports the establishment of a Joint Pension Tribunal in Alberta and British Columbia.

The Panel recommends that:

6.5.1-A The governments should work together to establish a Joint Pension Tribunal having the following characteristics:

- **The JPT should be a statutory body constituted under the statutes in each province, with quasi-judicial status.**
- **The JPT should be established on the "common member" model.**
- **The harmonized legislation should include a strong privative clause, such as that contained in subsection 242.3(2) of the British Columbia *Financial Institutions Act*, to ensure the maximum possible deference by the courts in favour of decisions issued by the JPT.**
- **The JPT should be dedicated to pension matters only, to preserve its status as an expert tribunal in the eyes of the courts, thereby also enhancing the deference paid to its decisions.**
- **The purpose of the JPT should be to hear appeals from administrators and other "applicants" (being any party who has submitted a plan for registration, or any other person subject to the directive powers of the regulator) in respect of decisions of the regulator.**
- **The JPT should be independent and at arm's length from the governments.**
- **The JPT should be bound by and able to establish precedents.**
- **The JPT should have balanced representation from both provinces.**
- **Members of the JPT should be appointed by the Lieutenant-Governors-in-Council in both provinces.**
- **The membership of the JPT should consist of a chair, vice-chair and other members, all of whom are recognized pension experts.**
- **The chair and vice-chair of the JPT could ultimately be full-time positions once appeal volumes are sufficient to justify it.**
- **There should be multiple members appointed, sufficient to respond to cases in a timely manner.**

6.5.2 Joint Pension Advisory Council

Issues

- How can the governments ensure that future pension policy is developed on a coordinated and harmonized basis between the provinces?

- If it is the role of the governments, but not the regulator, to promote the expansion of pension coverage, what structures can be put in place to achieve this goal?

Discussion

As discussed in Section 6.4, above, imposing an obligation on the regulator to promote the expansion of pension coverage would, in effect, overlay a conflicting duty on the regulator's specific enforcement obligations and cause confusion for all concerned as to how its powers should be exercised.

To achieve the objective of expanded coverage levels, one alternative would be for the governments to appoint an independent "pension advocate", whose role would be to promote the pension system, identify barriers and work with stakeholders and government to develop solutions to key pension issues.

In Section 6.4.1, the Panel recommended the creation of a pension advisory council to provide broad-based input to the governments on pension policy development. Such a body would help to reduce the need for periodic comprehensive reviews of the pension system. The governments would also benefit from the ideas and expertise of active participants in the system, rather than relying on anecdotal observations.

From the harmonization perspective, such a mechanism could be designed to ensure ongoing dialogue between the provinces and a coordinated approach to pension policy development. To create harmonized legislation and then leave it to run in the hope that informal dialogue will occur in order to maintain harmonization seems unrealistic. As noted above, pension standards legislation in Alberta and British Columbia was once virtually identical. Divergence over the course of the past 15 years has occurred, no doubt for legitimate reasons, even though informal dialogue has occurred between the provinces. The adoption of formal structures may be the only means by which there can be any assurance that a coordinated approach will be undertaken and maintained.

As discussed in Section 6.5.1, above, a CM approach also offers a potentially useful means to develop such a joint advisory structure.

Panel Perspectives and Recommendations

The Panel supports the concept of the creation of a joint advisory council, comprised of individuals from a variety of backgrounds, to provide ongoing input and advice to the Ministers and the regulator or regulators with respect to pension policy matters. A central figure in such a structure would also be uniquely situated to take on the roles on behalf of the governments, of promoting the pension system and the expansion of pension coverage.

The role of such a body would need to be enshrined in the legislation to give its input real weight. The scope of issues that could be dealt with by an advisory council would be different from that of an administrative tribunal, whose decisions would be specific to a particular case at issue. The council would promote ongoing harmonization and consistency with the principles and objectives of the legislation. The council would conduct its functions with a view to providing policy advice to the governments regarding the legislation.

The Panel recommends that:

6.5.2-A The governments should work together to establish a Joint Policy Advisory Council having the following characteristics:

- **The JPAC should be a statutory body created under the pension standards statutes in each of the provinces, and its members should be remunerated according to government guidelines.**
- **The JPAC should be established on the "common member" model.**
- **The stated purposes of the JPAC should be to:**
  - **provide policy advice to the ministers and the superintendent(s);**
  - **recommend changes to the legislation in both provinces as needed and provide input and advice on proposed amendments;**
  - **provide advice to the superintendent(s) on the administration of the legislation and the development of regulatory policies and guidelines;**
  - **promote continued harmonization between Alberta and British Columbia; and**
  - **encourage national harmonization.**
- **The JPAC should be appointed jointly by and report to the two ministers on a regular basis in respect of its activities.**
- **There should be balanced representation from both provinces in the membership of the JPAC.**
- **The JPAC should be of a workable size that is not too big, for example with a maximum of nine members.**
- **Membership on the JPAC should include representation from among pension plan sponsors, pension plan members and pensioners, professional service providers and government policy staff, with the superintendent(s) sitting on the JPAC in an "ex officio" capacity.**
- **The position of chair of the JPAC should be a permanent position, designated as the "Pension Advocate", and be responsible for and accountable to the ministers with respect to:**
  - **chairing the Council;**

- **promoting awareness of pensions, pension policy and retirement income planning among employers and employees, and promoting the expansion of pension coverage; and**
- **promoting financial education with respect to pensions and retirement savings.**

- **Membership on the JPAC, other than the chair, should be for fixed staggered terms, resulting in regular turnover in membership.**

6.5.3 Joint pension regulator

Issues

To the extent that pension standards legislation is harmonized between Alberta and British Columbia, could one joint pension regulator be appointed for the two provinces?

Discussion

For plans that operate in both Alberta and British Columbia, there can be little doubt about the appeal of a joint regulator charged with administering identical legislation in the two provinces.

From a harmonization perspective, even with identical legislation, there is a possibility, if not a likelihood, that regulatory interpretation of the legislation will diverge over the course of time. But, if a goal of the governments is to maintain alignment after the initial efforts towards harmonized legislation are complete, perhaps the simplest way to avoid that divergence would be for the governments to jointly appoint one regulator.

The Superintendent of Pensions in each province is an employee of the government which has appointed him. To have a joint regulator between the two provinces, serving under two different statutes, would likely require the individual to be an employee of both governments and appointed to the position by each. Questions would exist surrounding, for example, how such individual would be paid, in which compensation programs the individual would participate, how and to whom the individual would report and how the individual could be removed from office, if necessary.

A joint regulator is a novel approach in Canada, creating a variety of other issues that would need to be addressed, including:

- In order to properly serve the needs of the regulated plans in each province and to be able to respond to issues and problems in a timely fashion, offices would be required to be maintained in each province.

- To the extent that the existing regulator's offices are part of larger organizations within their respective governments, de-coupling of the pension regulatory functions would be required.
- The ability to continue to deliver service on an economically viable basis without resort to material fee increases would need to be evaluated.
- Each government would need to be assured that it has the ability to maintain control over regulation of matters within its exclusive jurisdiction, so as not to be charged by the electorate with having abdicated its responsibility.

However, each of these issues is of a practical nature and there are no obvious reasons why they could not be resolved through appropriate agreements and structures. It would be possible to structure the regulator's office as essentially the existing offices in the two provinces, each answering to one common superintendent. Existing staffs and facilities could continue to exist, and cost sharing and service contracting arrangements could be worked out internally within the governments. That is not to say that there will not be cost and complexity involved in the initial set-up of such arrangements. However, there is no reason to believe that such arrangements are not possible. Again, as with the JPT and JPAC discussed in Sections 6.5.1 and 6.5.2 above, a CM approach may also be useful in this area.

Panel Perspectives and Recommendations

The Panel strongly favours the creation of a joint pension regulator to administer harmonized legislation in the two provinces. The Panel sees no legal or practical reasons why such a structure could not be implemented, and the advantages of doing so, both for consistency of administration of the legislation and maintenance of long-term harmonization, would outweigh any inconvenience in the initial establishment of the structure.

The Panel recommends that:

6.5.3-A The governments work towards the establishment of a joint pension regulator to administer and enforce, on a consistent basis in both provinces, the recommended harmonized pension standards legislation.

7.0 Governance and Investment

7.1 Governance standards

Issues

Negative outcomes in pension plans often come about at least partly because of deficient governance practices. Best practices in governance have been widely discussed in the industry for several years in Canada and in other jurisdictions. A number of guidelines have been issued over the last two decades, including two important Canadian pronouncements: *Guideline No. 3 – Guidelines for Capital Accumulation Plans*, and *Guideline No. 4 – Pension Plan Governance Guidelines and Self Assessment Questionnaire*, released in 2004 by CAPSA after broad consultation with stakeholders.[32] Nonetheless, there has thus far been no appetite for introducing legislated standards for governance.

There is a large leap from guidelines to statutory provisions. The difficulty in defining what constitutes good governance, and monitoring it, has discouraged legislators from adopting such provisions. The legal consequences of poor governance most often play themselves out in the courts, which begs the question whether governance provisions should be adopted in the legislation.

Discussion

The numerous sets of governance guidelines that have appeared over the last several years and legislative developments in other jurisdictions illustrate that awareness in the international pension community of what constitutes good governance, and its importance to the integrity of the pension system, has heightened significantly over the past decade.

It is now generally agreed that pension plans (and regulators) can no longer ignore governance principles, with a range of regulatory approaches being adopted – from strongly suggested best practices to legislative requirements. While governments may have been reluctant to legislate governance standards, regulators and others have addressed the growing need for direction in this area with guidelines. For example, "*Guidelines for Pension Fund Governance*", issued by the Organisation for Economic Co-operation and Development in 2002, were designed to provide guidance to governments on the regulation of pension fund governance. While guidelines do not have the force of law, Canadian regulators have attempted to fill the gap with explicit expectations.

[32] Other governance guidelines issued in Canada were the report of the Toronto Stock Exchange Committee on Corporate Governance in Canada *"Where Were the Directors": Guidelines for Improved Corporate Governance in Canada* (December 1994) and *Effective Pension Plan Governance* – Dec 21 1999 – Association of Canadian Pension Management, Pension Investment Association of Canada and the Office of the Superintendent of Financial Institutions Joint Task Force on Pension Plan Governance.

A survey of the numerous sets of guidelines and other requirements in various jurisdictions shows that our understanding of the elements that constitute best practices in pension plan governance is growing, and that there is a high degree of consensus on what they should include.

For instance, we know that an effective governance model starts with the pension promise itself: a clearly understood promise, addressing pension entitlements, funding policy and provisions for management oversight is the fundamental basis for the governance framework. Regardless of the type of plan involved, the risks and uncertainties and who bears them must be explicitly identified. Stewards of pension plans must be clear as to who the stakeholders in the plan are and what loyalties and benefits are owed to each. The beneficiaries of any rewards that might accrue from superior investment returns and favourable actuarial experience must be clear.

We know that a funding policy is necessary to ensure that fiduciaries understand and follow a clearly thought-out strategy suited to the objectives of the plan, and designed to reduce the risks and costs of providing the expected retirement income. CAPSA suggests in its 2004 *Proposed Funding Principles for a Model Pension Law* for example, that a funding policy might address the instances when a benefit improvement is appropriate, what impact is acceptable to the funded status of a plan as a result of improvements, how the plan will deal with funding deficiencies – reflecting at minimum the statutory requirements, but also potentially requiring accelerated funding of the deficiency beyond the statutory requirements – the economic assumptions and costing methods to be used in valuations, the frequency of valuations, the use of surplus and contribution holidays and linkages to the plan's investment strategies. CAPSA also suggests that a funding policy could be required, and could be made available to the regulator upon request, without requiring that the policy be regularly filed with the regulator.

We know that there must be appropriate mechanisms in a plan's governance structure to oversee and ensure compliance with legislative requirements, plan documents and administrative policies, whether through a separate governing body or a clearly delineated role for the sponsor, separate and apart from its general business objectives. Whether plan administration is to be undertaken by the sponsor's board of directors, a board of trustees or a pension committee, the administrator is subject to the laws of fiduciary duty – and must exercise the care, skill and diligence of a prudent person in carrying out their duties. Plan members are vulnerable to the fiduciaries, and this unequal relationship defines the need for duty, care and prudence. The greater the discretionary power, the greater is the scope of fiduciary duties. Although the terms of the plan design are frequently set unilaterally by the plan sponsor, they must be interpreted impartially, fairly, and in good faith when paying the benefit promised. In their role as fiduciary, the administrators or trustees must always act in the best interests of the beneficiary, impartially treating members with loyalty and without personal profit.

Given all we have learned about good governance, today's debate turns to what extent governance should be regulated – and if so, how. Are best practices guidelines sufficient to ensure that pension plans meet the standards that we now understand to be so important? Or should governments be doing more to protect pension plan beneficiaries in cases where best governance practices are not being adopted?

Both the Alberta and British Columbia statutes already contain several governance provisions, e.g. fiduciary responsibility, prudent person rule for investing and requirements for transparency and accountability. Some of these provisions are "principles-based" (i.e. they are not set out as a list of detailed prescriptive rules, but rather as broad principles), others are prescriptive or "rule-based" provisions, and some are a blend of the two.

For example, existing provisions in both provinces on the fiduciary duty owed by plan administrators are set out as broad principles in the legislation:

> British Columbia – PBSA
>
> In the administration of a pension plan, the administrator must:
>
> a) act honestly, in good faith and in the best interests of the members and former members and any other persons to whom a fiduciary duty is owed; and
> b) exercise the care, diligence and skill that a person of ordinary prudence would exercise when dealing with the property of another person.[33]

> Alberta – EPPA
>
> While acting in the capacity of administrator, the administrator stands in a fiduciary capacity in relation to members, former members and others entitled to benefits.[34]

Requirements relating to how plan assets must be invested are set out as broad principles in the legislation:

> British Columbia – PBSA
>
> Pension plan assets must be invested in a manner that a reasonable and prudent person would apply in respect of a portfolio of investments made on behalf of another person to whom there is owed a fiduciary duty to make investments without undue risk of loss and with a reasonable expectation of a return on the investment commensurate with the risk.[35]

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[33] *Pension Benefits Standards Act* s. 8(5).
[34] *Employment Pension Plans Act* s. 13(5).
[35] *Pension Benefits Standards Act* s. 44(2).

> Alberta – EPPA
>
> Assets of a pension plan must be invested, and the investments must be made, in accordance with the regulations and in a manner that a reasonable and prudent person would apply to the plan's portfolio of investments having regard to the plan's liabilities.[36]

Those principles are supported by detailed rule-based provisions in the regulations. Both provinces supplement the broad principles as set out above by adopting the detailed quantitative rules contained in Schedule III to the federal *Pension Benefits Standards Regulations, 1985*.

At the other end of the spectrum, disclosure requirements in both provinces are rules-based, listing each and every item and how, when and to whom it must be disclosed.

The issue of principles vs. rules-based legislation is discussed in Section 6.2. Most of the submitters that commented on this topic believe that pension legislation should contain a mix of principles and rules, depending on the nature of the provision. Governance, disclosure and investment are three areas that stakeholders have identified as lending themselves to a more principles-based approach.

Panel Perspectives and Recommendations

The Panel believes that including governance principles in the legislation would foster good pension plan governance in the interests of protecting plan members. It would raise the bar that measures good governance and help to instill a "culture of compliance" with the principles rather than the "check-box mentality" that prescriptive rules have been said to promote.

The CAPSA guidelines are based on principles that were developed in full consultation with regulators and other pension stakeholders, and are generally agreed upon as the Canadian standard for pension plan governance. While some have argued that broad principles may prove difficult for the regulator to administer, the Panel believes that including such principles in the legislation would provide a legislative framework for pension plan governance that would also encourage the role of the regulators to change, by providing them not only with the legislative authority to review plan governance, but also to promote good governance by educating plan administrators and allowing them to be more visible in dealing with egregious conduct.

Some stakeholders believe that the governance guidelines do not need to be in the legislation, that the pension community already recognizes them as best practices, and the courts may, in fact, already rely on them as industry standards. In the Panel's view, this

[36] *Employment Pension Plans Regulation* s. 54.

means that many Canadian pension plans are already either in compliance, or working to develop policies and procedures to come into compliance with these guidelines. Codifying them would make them legally enforceable so that regulators could ensure that pension plans are structured and operated in a manner that protects both sponsors and beneficiaries.

Governance policies focus plan administrators' attention on proper governance by requiring them to spend the time to consider how it should apply in their own plans. Routinely disclosing plan governance policies to interested parties ensures that all stakeholders in the plan have an understanding of the plan structure and the roles and responsibilities of all participants.

Funding policies help to protect both sponsors and beneficiaries by clearly setting out plan policies on contentious funding issues before disputes arise. Stakeholders who commented on governance issues in their submissions were generally supportive of CAPSA's governance guidelines, the suggestion that every plan should be required to have a funding policy, and general principles of good governance. As CAPSA notes, funding decisions have an immediate and significant impact on the beneficiaries, and potentially impact employer costs, the security of member benefits, and the soundness of the plan itself. They should not be made on an ad hoc basis – but rather should be consistent with the goals and purposes of the pension plan and be related to a long-term policy. The development of a funding policy by sponsors supports decision-making processes and enhances the transparency of the plan and the accountability of the plan administrator. The Canadian Institute of Actuaries has also proposed that every pension plan be required to have a funding policy in order for an actuary to be able to prepare a valuation in accordance with accepted actuarial practice.

With respect to regulatory filings, in a risk-based regulatory environment, governance and funding policies would be required to be made available for inspection upon request, but would not be required to be filed. A filing requirement may suggest that the regulator approves each policy, which we do not believe would be an efficient use of regulator time.

The Panel recommends that:

7.1-A The principles contained in CAPSA's governance guidelines should be adopted as a schedule to the legislation, in a way that explicitly incorporates them into pension law and makes them straightforward to update, as necessary. (See also Recommendation 6.1-G regarding adoption of professional standards.)

7.1-B Every plan should be required to have a governance policy. Plan governance policies should be required to be:

- **approved by the governing parties;**
- **updated regularly;**
- **brought to the attention of members and other beneficiaries;**

- **available upon request to all members and other beneficiaries; and**
- **available to the regulator upon request, but not required to be regularly filed.**

Required elements of a plan governance policy should be specified, possibly in regulation – similar to the rules relating to the contents of a Statement of Investment Policies and Procedures (SIPP). At a minimum, plan governance policies should include:

- **a profile of the pension plan: a summary of the plan's key features, its purpose, who makes contributions and how they are determined, how benefits are defined and determined and how the fund is established, held, managed and invested;**
- **a description of the key elements of the governance structure: the composition of any board, and the basis on which decisions are made and implemented;**
- **a summary of how business is to be conducted: timing, location and frequency of meetings, how a quorum is obtained, how meetings are to be recorded and how the voting system is to operate;**
- **a detailed description of the roles and responsibilities of each party included in the governance structure;**
- **a description of when and how the administrator may employ agents and advisors in carrying out its duties, including standards for the appointment, reporting requirements and evaluation of such agents or advisors;**
- **a listing of stakeholders and a description of their interests in the plan;**
- **the standards of performance expected of the administrator (including those expected of trustees, both individually and collectively), including:**
  - **a code of conduct that addresses expectations for meetings, relationships between trustees, with agents/advisors and with members**
  - **a policy regarding conflicts of interest**
  - **an assessment of educational requirements and training needs for those who have responsibility for aspects of plan administration**
  - **planning and performance measures**
  - **the use of agents and advisors**
  - **communication to stakeholders**
- **a funding policy (see also Recommendation 7.1-C below);**
- **a SIPP (already required in current legislation); and**

- **a remuneration and expense policy for trustees, if applicable.**

7.1-C Every pension plan that includes either a DB or "target" benefit provision should be required to have a funding policy. The funding policy should be part of governance policy and should be made available to the regulator for inspection upon request. However, it should not be required to be filed. Necessary elements of a plan funding policy should be specified, possibly in regulation – similar to the contents of a SIPP. At a minimum, plan funding policies should include:

- **an explanation of the purpose of the policy;**
- **a summary of the risks to which the plan's funded status is exposed;**
- **a description of the policies adopted to protect the plan's funded position against the risks identified (e.g. asset valuation methodology, how economic assumptions are developed, funding margins, funding thresholds for benefit increases and decreases); and**
- **an explanation of how the funding policy was developed (the rationale for the policy selected to protect the plan's funded position against the risks identified).**

7.1.1 Trustee / fiduciary education

Issues

Governance can only be as good as the people who govern. For that reason it is important that individuals who have statutory fiduciary responsibility have appropriate knowledge and skills. While this is particularly important for Boards of Trustees who have the final responsibility for the plan, the Panel notes that it also important in plans where there are corporate statutory fiduciaries (like single employer DB plans) that individuals within the organization with responsibility for administering the plan receive suitable training. (It is less important only because there is a corporation standing behind the liabilities of the plan and the Board of the corporation has the responsibility to ensure good governance in all areas of the corporation.) Many recent studies[37] have shown that one of the major challenges to good governance is that many with fiduciary responsibilities for pension plans do not have the necessary training to fulfill those responsibilities.

Discussion

Across Canada, pension standards legislation generally specifies that the administrator of a pension plan must exercise the care, diligence and skill of a prudent person when carrying out the administration of a pension plan and investing pension funds, or else specifically identifies the administrator as a fiduciary or trustee. In Quebec, the administrator must be

[37] E.g.OECD Working paper #18 on governance June 2008.

a pension committee. Outside of Quebec, the plan administrator is usually the employer corporation acting through its board of directors or a board of pension trustees.

There is no statutory requirement in Alberta or British Columbia for the administrator to have or use any relevant special knowledge. This is in contrast to some other Canadian jurisdictions where administrators are required to have and use expertise. For example, both the Ontario *Pension Benefits Act* and the federal *Pension Benefits Standards Act* require administrators use all relevant knowledge and skill that they possess or, by reason of their profession, business or calling, ought to possess."[38]

The question of fiduciary qualifications and training has been considered in a number of countries over the last several years with a variety of results. A 2001 report following a review of occupational pension fund governance in the United Kingdom revealed that pension funds were poorly governed and over-relied on the advice of consultants regarding investment strategy. A survey of 55 local authority pension funds in 2004 found that trustees lacked sufficient knowledge and understanding necessary to challenge the advice offered by consultants and to make informed investment decisions.[39]

In response, several reforms were introduced in the United Kingdom aimed at improving pension fund expertise and representation. Pension trustees are now required to have knowledge and understanding consistent with their responsibilities, including appropriate knowledge and understanding of the law relating to pensions and trusts, the principles relating to the funding of occupational pension plans and the investment of the assets of such plans. Trustees are also required to be conversant with their own plan's policy documents: a working knowledge of the documents and an ability to use them effectively when carrying out trustee duties. A code of practice was also developed to provide trustees with guidance on the scope of their knowledge and understanding obligations.

In Australia, the concept of the trustee as the sole responsible entity in relation to the operation and management of the pension fund was introduced in 1993. The legislation relied heavily on a principles-based prudent person approach, with an emphasis on the fiduciary responsibilities of trustees. In 2002, amid concerns about the adequacy of governance, particularly trustee competence, risk management systems and disclosure, the Australian government introduced changes to the legislation, including a requirement for licensing of trustees and a fitness and propriety standard that requires licensed trustees to have a basic understanding of investments and regulatory requirements, including their duties and responsibilities as trustees.

While corporate governance became a hot-button issue in the wake of a number of large-scale corporate failures, little emphasis has been placed on the internal governance of pension plans in the United States. The *Employee Retirement Income Security Act*

[38] Ontario *Pensions Benefits Act* s.22(2); Federal *Pension Benefits Standards Act* s. 8(5).
[39] Stuart Imeson, Delegating Shareholder Engagement – Local Authority Pension Funds and Fund Managers: A survey of policy and practice (West Yorkshire: Local Authority Pension Fund Forum, July 2004) [Interim Report] at 4.

(ERISA) establishes the obligations and duties owed by fiduciaries to pension plan members, and includes extensive reporting and disclosure requirements, but there are no requirements for fiduciaries to have specific educational backgrounds or training with respect to the general administration of the pension plan. (See, however, comments in Section 7.2 below regarding the ERISA prudent expert standard for pension plan investing.)

Panel Perspectives and Recommendations

The concept that persons involved in pension plan administration should have the knowledge and skills that are appropriate to meet their governance responsibilities is considered best practice and is reflected in many of the governance principles or guidelines for pension plans that have been developed over the years. It is reasonable to conclude that individuals would be unable to meet their obligations to act in the best interests of pension plan members unless they have achieved at least a basic level of financial literacy, a general understanding of pensions, the legal principles of fiduciary duty and a working knowledge of their roles and responsibilities. Better educated fiduciaries result in better governance, better protection of beneficiaries and greater protection from legal challenges.

Where a board of trustees is the plan administrator, the Panel believes that it is critical for the individual trustees to have the appropriate skills and training to meet their statutory fiduciary obligations. In the case of corporate statutory fiduciaries, no individual bears the legal fiduciary obligation of the administrator because it is the corporation itself that is the administrator. However, as a matter of good governance (see Section 7.1 "Governance standards" above), these corporate pension plan fiduciaries should be strongly encouraged to identify the individuals within the organization with responsibility for administering the pension plan and obtain appropriate training for them.

Requirements for fiduciary education could be designed as broad principles in the legislation, with the option of specifying training programs or types of training in the regulations, if desired. Listing specific training programs, however, would require increased regulatory resources to assess the quality of available courses.

While requiring training may be an added burden to fiduciaries and could discourage people from becoming pension plan trustees, the Panel believes that the importance of properly educated fiduciaries to proper pension plan governance outweighs these concerns. While some may argue that increased training requirements could increase plan costs, if appropriate courses were offered locally, the costs of accessing training could actually be reduced. While it is accepted that this cannot happen overnight, it is recommended that a suitable timeframe be included in the legislation, by which time current fiduciaries should have the relevant training. It should be noted that this requirement for training should not exclude individuals with professional qualifications such as actuaries, lawyers and accountants.

Although several training programs are currently available, and it is already common practice for plans to require or encourage trustees to participate, existing programs do not provide for all of the training needs of fiduciaries. In addition, few programs are offered in Alberta and British Columbia, resulting in significant travel commitments for local fiduciaries seeking training.

The Panel recommends that:

7.1.1-A Administrators and trustees should be required to have and use the knowledge and skills required to fulfill their obligations.

7.1.1-B Individuals who have statutory fiduciary responsibility for pension plans should be required to obtain certification from suitable training programs within a suitable period after their appointment. Failing to meet the educational requirements within an appropriate timeframe should result in disqualification of the individual and loss of any "business judgment" defence that would otherwise have been available to the remainder of the board. (See also Section 7.3 "Fiduciary protection" below.)

7.1.1-C Educational programs to train individuals having statutory fiduciary responsibility should be further developed and offered at the post-secondary level in both provinces. With appropriate further development, completion of the courses should enable certification of the individuals.

7.1.2 Disclosure to members

Issues

While some stakeholders said that existing disclosure requirements are sufficient, some submitters suggested that additional disclosure should be required with respect to such items as the financial health of plans or the plans' funding policies. There was particular emphasis on the need to ensure that plans designed to deliver a target benefit clearly explain the target nature of the promise to beneficiaries. The need for beneficiaries to understand how to make enquiries about specific aspects of plans was also raised.

Discussion

Many areas of this report discuss appropriate disclosure. In addition, our recommendation to move to a more principles-based approach (principles where possible, rules where necessary) suggests that disclosure is an area where rules will be required, to provide certainty to plan administrators as to what needs to be disclosed. Exactly what should be disclosed, when and how, should be the subject of legislation, or perhaps regulation (more easily updated and kept current).

Specific recommendations included in this Report refer to the existence and disclosure of a governance policy (including a funding policy and SIPP), and recommended disclosure requirements for Specified Contribution Target Benefit Plans (see Section 8.2 below). In addition, the CAPSA Guidelines, which we recommend be incorporated into the legislation, include:

- a principles-based disclosure requirement to provide for the communication of the governance process to plan members, beneficiaries and other stakeholders to facilitate transparency and accountability, and
- specific disclosure requirements for DC plans.

Panel Perspectives and Recommendations

While the Panel accepts that the existing disclosure requirements in Alberta and British Columbia are appropriate, our view is that the more that can be disclosed to members and the clearer the disclosure the better. At the same time, administrators want clear guidance on disclosure. Placing a general requirement in the legislation that key information must be disclosed to members and other stakeholders in a timely manner, with details in a regulation, would simplify the statute while preserving the detailed guidance the Panel believes is necessary.

At the same time, the Panel is concerned that, where possible, disclosure requirements should be tailored to specific types of plans. For example, disclosure about the "target nature" of the benefit promise is exceptionally important for Specified Contribution Target Benefit plans (SCTBs) (see Section 8.2), but is not applicable for DB plans. Setting out detailed disclosure requirements for different types of plans in a regulation would make the standards more flexible and adaptable in anticipation of the potential creation of different pension models in the future for which disclosure requirements may not be known at present.

While the Panel supports a move to more principles, disclosure requirements are one area that the Panel believes should remain rules-based, in order to provide clear guidance to plan administrators on what needs to be disclosed, when and to whom. In the Panel's view, a principles-based disclosure standard would not meet the needs of administrators or plan beneficiaries, both of whom would prefer the certainty provided by a checklist approach for disclosure.

The Panel recommends that:

7.1.2-A The legislation should require that pension plan administrators disclose to members key information affecting the member's participation, obligations or entitlements, in accordance with detailed disclosure rules as prescribed in a regulation.

7.1.2-B The disclosure rules should be tailored to different plan types – a legislative requirement to disclose key information should be supported by specific rules for different types of plans and at a minimum, should state the occasions on which disclosure

statements must be provided, what items must be in the statements for that type of plan and who should receive the information.

7.1.2-C Electronic methods of disclosure should be explicitly permitted in the pension standards legislation, subject to their effectiveness in transmitting information to members and other stakeholders, i.e. there may be a need to address disclosure methods for stakeholders that do not have computer access.

7.1.2-D Administrators should be required to notify members, in their annual statement, that the plan has a governance policy, that the policy is available for review and how the members may access the policy.

7.2 Investment rules

Issues

Pension fund investment rules were originally based on a specific list of permitted investments – the so-called "legal for life" list. More recently, the trust law principle of the "prudent person" was explicitly added to the standards. In addition, some quantitative limits remained, dealing with diversification, non-arm's length transactions and passive investment.

Many jurisdictions outside of Canada have moved completely to the "prudent person rule" with few or no quantitative constraints. In fact, the prudent person concept has evolved into three levels of prudence, variations of which may be found around the world:

- decisions must be made in the same manner as a person of ordinary prudence
- decisions must be made in the same manner as a person of ordinary prudence, but a person who has expertise (or should have it due to their profession or calling) must bring it to bear
- decisions must be made in the same manner as a person who is prudent and an expert in the field would make them

Should Alberta and British Columbia move to a higher standard for prudence in pension plan investing? If so, should British Columbia's reference to "best financial interests" remain? Should the investment decision maker be required to have specific skills or expertise? Should any limits or prohibitions be maintained?

Currently in Alberta and British Columbia, variations on the "prudent person" rule are found in the legislation while the key quantitative limits are included by reference to Schedule III of the federal *Pension Benefits Standards Regulation*.

In British Columbia, the existing investment rules may be summarized as follows:

- "Pension plan investments, loans and other pension plan financial decisions must be made in the best financial interests of plan members, former members and other plan beneficiaries."[40]
- "Pension plan assets must be invested in a manner that a reasonable and prudent person would apply in respect of a portfolio of investments made on behalf of another person to whom there is owed a fiduciary duty to make investments without undue risk of loss and with a reasonable expectation of return on the investments commensurate with the risk."[41]
- The administrator must establish a written statement of investment policies and procedures in respect of the plan's portfolio of investments and loans having regard to all factors that may affect the funding and solvency of the plan and the ability of the plan to meet its financial obligations.[42]

In Alberta, the rules are similar, but not identical:

- "The assets of a pension plan must be invested, and the investments must be made…in a manner that a reasonable and prudent person would apply to the plan's portfolio of investments having regard to the plan's liabilities."[43]
- "The administrator must, having regard to all factors that may affect the funding and solvency of the plan and the ability of the plan to meet its financial obligations, establish a written statement of investment policies and procedures in respect of the plan's portfolio of investments."[44]

Discussion

While the prudent person standard of care appears to be generally accepted by those currently engaged in this debate in Canada, it is not clear whether an "expert" standard of care would be regarded as welcome or necessary. Both the Ontario *Pension Benefits Act* and the federal *Pension Benefits Standards Act* apply a higher standard, requiring that administrators use all relevant knowledge and skill that they have or, by reason of their occupation, ought to have.

ERISA in the United States applies yet a higher standard to pension plan investments than Ontario and the federal government. It requires that a fiduciary invest pension plan assets "with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent man acting in a like capacity *and familiar with such matters* would use in the

[40] PBSA s. 44(1).
[41] PBSA s. 44(2).
[42] PBSR s. 38.
[43] EPPR s. 54.
[44] EPPR s. 51.

conduct of an enterprise of a like character and with like aims." [emphasis added] The requirement for "familiarity" with such matters is an example of the higher standard referred to as the "prudent expert" rule.

Submissions received by the Panel show that many complaints have arisen about the quantitative limits, two specific irritants being the diversification rule (not investing more than 10 percent of plan assets in any one entity) and the passive investment rules (not holding more than 30 percent of the votes of an investment entity). In both instances large plans have argued that the rules arbitrarily restrict their pursuit of investment opportunities that are in the interests of their beneficiaries.

The prudence standard is seen by many to be the most flexible, while at the same time sufficiently protective standard, although the protection does not lie in regulator oversight. Although most statutes embody the standard explicitly, regulators' ability to monitor and enforce prudence is limited, and they have tended to focus on compliance with Schedule III. If a plan fiduciary is believed to have acted imprudently, the members' recourse is generally through the courts and the common law.

The evolving common law can act as instruction and deterrence to fiduciaries, but case law is always reactive: it arises out of unfortunate events, after the damage is done and usually after there is any hope of remedy. To make oversight of pension plan investments more proactive, the legislation could either further refine the rules that the regulator can use as a measuring stick, or concentrate on the basic prudence principle with clear authority for the regulator to make judgment calls on prudence and require remedial action.

Alternatively, the current common law system could be maintained as the best avenue for upholding the prudence principle, in which case it might be wise to relieve the regulator explicitly of the obligation to police prudence.

Panel Perspectives and Recommendations

Consistent with the approach taken by many other jurisdictions and the views of those stakeholders that commented on this issue in their submissions, the Panel believes that the investment rules should be set out as broad principles, and that most of the prescriptive quantitative restrictions should be abandoned. The current diversification limits could be incorporated reasonably into prudent person principles. The passive investment requirements are, arguably, no longer valid or, indeed, desired – maximizing return for a given level of risk may, in fact, require active participation in the management of an entity (see the discussion below in Section 7.2.1 "Environmental, social and governance factors"). Safeguards against conflict of interest however, should be maintained, as they are meant to protect the plan against conduct that by its very nature would undermine a principles-based framework.

In order for the prudence principle to operate appropriately for pension plans, the Panel believes that specialized expertise should be required to ensure that appropriate investment strategies and decisions are being made. If not possessed by the governing fiduciary, the plan should be required to seek and avail itself of an appropriate level of expertise, but must still have sufficient knowledge to understand and question the advice provided in this very specialized and important facet of plan and fund management.

The Panel recommends that:

7.2-A Alberta and British Columbia investment standards should be "uncoupled" from the federal Schedule III, to remove quantitative restrictions on investment and increase reliance on the prudent investor principle.

7.2-B Specific rules in Schedule III that protect against conflicts of interest (related party rules) should be integrated into provincial legislation.

7.2-C The existing "prudent person rule" with respect to investment of pension plan assets should be expanded to incorporate a requirement for expertise. Plan assets should be invested in a manner similar to the way in which a prudent expert would invest them. If the required expertise is not possessed by the governing fiduciary, the plan should be required to seek and avail itself of an appropriate level of expertise, but must still have sufficient knowledge to understand and question the advice.

7.2.1 Environmental, social and governance (ESG) factors

Issues

In common law jurisdictions, pension plan trustees have a fiduciary obligation to invest pension plan funds in the best interests of the plan members. The classical understanding of "best interests of the plan members" is to focus on the maximization of returns to the exclusion of all other concerns. This view is expressed by economists such as Milton Friedman, who wrote: "Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholder as possible." Such a view was seemingly reinforced in the influential ruling in *Cowan v. Scargill* ("*Cowan*")[45] where Megarry V-C stated: "the paramount duty of the trustees is to provide the greatest financial benefits for the present and future beneficiaries."

The *Cowan* ruling, combined with our existing statutory provisions, has meant many pension fund managers design funds with the sole purpose of maximizing capital accumulation. However, certain groups, including a number of unions and churches, have expressed concern over this narrow focus, arguing that they should not be obligated to

[45] [1985]1 Ch 270; [1984]2 All ER 750.

invest in corporations they view as being involved in immoral or unethical practices or as engaging in practices detrimental to the broader interests of the plan's beneficiaries, even if they offer a high rate of return.

Internationally, a growing interest in ESG investing is reflected in the collaboration of the United Nations Environment Programme Finance Initiative (UNEP FI) and the United Nations Global Compact to establish *Principles for Responsible Investment* (PRI), six key principles for responsible investment. In Canada, the movement to allow for ESG considerations in pension investment has been enshrined in statute in Manitoba, where the *Pension Benefits Act* was amended to allow for criteria other than financial considerations to be used to formulate investment policy.

Consistent with these trends, some stakeholders have advocated the adoption of legislation that expressly allows for ESG criteria to be considered in the formulation of pension plan investment policy. The specific wording in the British Columbia *Pension Benefits Standards Act* that requires making decisions "in the best financial interests" of plan members and other plan beneficiaries is considered problematic by some parties in that it may preclude any other considerations. Other stakeholders strongly disagree.

Whether pension standards legislation should explicitly refer to ESG or "non-financial" considerations in the investment rules raises a number of questions:

- Should trustees have to maximize financial gains of plans?
- Should trustees be able to weigh other considerations?
- Do ESG considerations affect returns (either positively or negatively)?
- Should governing fiduciaries be permitted/required to include these considerations?
- Should trustees be required to disclose an investment plan that outlines whether, or to what extent, ESG considerations were used to determine what investments to make?
- Can governing fiduciaries have duties other than the maximizing of returns?
- Should governing fiduciaries have the ability to pursue ESG initiatives through active, rather than passive, participation on company boards?

Discussion

There are several background assumptions or questions that should be noted when considering the question of ESG and pension plan investment decisions. First, those who argue that rates of return should be paramount over ESG considerations are assuming that taking ESG factors into consideration lowers the rate of return. If, in fact, this assumption is true, then legislation that would permit ESG factors to be considered means fiduciary duties would have to be broad enough to encompass non-financial concerns. However, the problem may not arise if two different investment opportunities have equivalent financial forecasts and ESG criteria are used as a tie-breaker.

On the other hand, some would argue that considering ESG factors does not lower returns. For example, a joint report by Mercer and UNEP FI titled *Demystifying Responsible Investment Performance*[46] concluded that applying ESG criteria did not lower returns. In addition, the Freshfields Report (an initiative of UNEP FI which researched the ESG practices in various countries)[47] also noted that taking ESG factors into account does not hurt returns, while at least one stakeholder submission to the Panel argues that there is no conclusive evidence on how ESG factors affect returns.

Related to this question is the problem of which ESG guidelines are to be considered. For example, internationally, funds have signed on voluntarily to follow the PRI, while others are following the United Nations' 10 Principles of the Global Compact.[48] Other funds have adopted more specific criteria. For example, the pension fund of the Environmental Agency in the United Kingdom places an emphasis on corporations with good environmental records, requiring their managers to justify any investment in a company with a controversial environmental record.

Thus, determining whether ESG affects returns is complicated by a lack of consistency in determining what ESG factors were considered and what weight was attached to them. In addition, there is the question of what to do when there are contradictory reports. For example, in one Panel discussion with stakeholders, the question arose of how to classify an investment in a corporation with a strong environmental record but poor labour relations – would this be considered a good ESG investment?

Those who argue that ESG does not lower, and can in fact raise returns, suggest that corporations with good ESG records make good investments. This is especially true for investments made by pension funds where the investment timeline is longer than for individual investors. The argument is that while companies with poor ESG performance may be profitable in the short term, over time their poor performance will catch up to them. One example could be a company with a poor environmental track record – in the short term this company may out-perform its rivals by cutting corners on environmental protections; however, such corner-cutting may come back to haunt it in the form of a lawsuit, penalties or a government-ordered clean-up. Another example is that of a tobacco company – a decision not to invest in one could be based on a moral objection to tobacco,

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[46] *Demystifying Responsible Investment Performance – A review of key academic and broker research on ESG factors* – A joint report by The Asset Management Working Group of the United Nations Environment Programme Finance Initiative and Mercer (October 2007).

[47] *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment* – Produced for the Asset Management Working Group of the UNEP Finance Initiative – Freshfields Bruckhaus Deringer (October 2005).

[48] The Global Compact is a United Nations initiative to encourage businesses worldwide to adopt sustainable and socially responsible policies and to report on their implementation. It was officially launched on July 26, 2000.

but could also be supported by the fact that class actions and increasingly stringent bans on smoking could curtail cigarette use and decrease the company’s profitability.

While the profitability of strong ESG companies may be a compelling argument, if true, it raises the question: if considering ESG factors makes for a good investment, why then would there be a need to legislate exceptions to the general rule to allow for it?

The questions surrounding the impacts of following ESG criteria may be one reason that most submissions to the Panel on this topic favoured permissive rather than restrictive legislation. Legislation similar to the Manitoba provision would give administrators the flexibility to decide whether or not to consider ESG factors. For those administrators looking for such flexibility, perhaps due to pressure from their plan members, this kind of legislation may ease their fears about whether taking ESG into consideration is compatible with current fiduciary duties. However, such flexibility could put pressure on an employer to take ESG factors into account and, if such considerations led to a lower rate of return, could increase the financial burden on an employer operating a DB plan.

In addition to allowing for the consideration of ESG criteria, some stakeholders have argued that administrators should also be required to disclose to their members whether, or to what degree, ESG factors were considered in making investments. These stakeholders point to Principle Six of the PRI which states: “We will each report on our activities and progress towards implementing the Principles.” Those favouring this form of disclosure argue that administrators have a duty to inform their members of the decision-making process and that this should include ESG criteria. While such disclosure may help plan members to understand why certain investments were being made, it could also be confusing, as different plans may use different criteria for making decisions.

Most stakeholders did not advocate for a mandatory requirement to consider ESG criteria. Those in favour of this approach argue that such investments could be both financially and ethically responsible, and that these investments have the potential to benefit society by rewarding responsible companies. Those against argue that it is the responsibility of the administrator to maximize rates of return and that a failure to do so could have far-reaching effects if retirees are faced with the prospect of retiring with a smaller pension fund pool.

Whether legislation should be written to allow or require the consideration of ESG factors, some stakeholders have expressed the opinion that administrators should be required to include in their plans their policy with respect to ESG. The administrator would then be required to follow the policies outlined the plan. While current regulations require plan administrators to complete a SIPP, it is not a condition that ESG considerations be disclosed. Those in favour of allowing ESG factors argue that including them in the SIPP would more formally authorize the administrator to weigh these criteria alongside other considerations such as minimizing risk and diversifying the portfolio.

A related question is whether a plan should be allowed to exercise active control over entities in which it has invested. There are some who feel that promotion of ESG criteria can be best accomplished through taking ownership positions in corporations and pressing for increased compliance with such socially responsible guidelines. This type of approach is currently precluded by the limits on ownership levels found in the quantitative limits in Schedule III.

It could be argued that an activist stance on investments is in fact an obligation of a large pension fund for the sake of ensuring that investments perform as well as possible for plan beneficiaries. This argument was put forth most notably by management consultant and writer Peter Drucker, who argued that pension funds need to grow so as to benefit an employee in 15 or 20 years and not in six months, and that this requires them to exercise more control over investee corporations to ensure longer-term growth rather than attempts for a quick buck. This concept has been further reinforced by the size to which pension funds have grown – to such an extent that, individually and collectively, they own such large percentages of corporations that their ability to sell their stock is greatly reduced. Moreover, even if a sale were possible, the most likely buyer would be another pension fund, which would not reduce the percentage of corporations controlled by such funds. This inability to sell means many pension funds are now, by necessity, in for the long haul.

Panel Perspectives and Recommendations

Some would argue that changes are unnecessary, especially because many plans are already applying ESG principles. The Panel heard that the requirement in the British Columbia legislation that investments be made in the "best financial interests" of plan members has apparently been helpful to plans that already engage in substantial ESG investments. It is possible that the current wording strikes the right balance – allowing ESG if it can be defended from a prudence and/or "financial best interests" perspective.

The Panel believes that changes are, indeed, necessary to the investment rules for a number of reasons:

- The rules in Alberta and British Columbia are similar, but different, so our harmonization objective requires at least some change.
- There is currently confusion over what the legislation permits or prohibits.
- A lack of case law reinforces uncertainty (but could also be a sign of general contentment with the law as it is now written).
- Some emphasis on financial gains may be desirable.

The Panel considered three options for changing the investment rules in respect of ESG:

- Permit ESG investment but not require it: this could bring greater certainty to the area, preserve flexibility (funds may choose to follow the criteria or not) and allow plan members to choose their own method of investing. This is, arguably, the current situation. However, it could reduce rates of return – and explicitly permitting ESG begs the question, in the context of prudent person principles, of what else can or cannot be considered. A specific reference to ESG or "nonfinancial considerations" could also increase pressure on administrators to invest in various causes not necessarily in the members' or the plan's best financial interests.

- Require disclosure of ESG policies: this could provide greater certainty for administrators, preserve flexibility, and encourage plans to follow ESG criteria, but it may be hard for plan members or regulators to hold funds to a consistent "measuring stick," and it might encourage funds to place more emphasis on ESG criteria than on returns.
- Require plans to consider ESG factors: this approach may increase certainty for administrators and, some would argue, may be the only way to ensure the long-term sustainability of investment choices. However, it would also reduce flexibility for administrators, and it may be difficult for them to determine which ESG factors they should consider. Furthermore, it could reduce returns, and it begs the question, in the context of prudent person principles, of what other types of factors should be taken into consideration.

The Panel is not convinced that a focus on ESG factors to the exclusion of other factors would be a positive change. However we do believe that some clarification is required in this area to explicitly allow, and in fact require, that all types of plans consider all relevant factors when making investment decisions.

The Panel recommends that:

7.2.1-A The fiduciary standard for the investment of pension plan assets should be amended to reflect the following wording: "Pension plan fiduciaries must make plan investment and other financial decisions in the best financial interests of plan members, former members and other plan beneficiaries, taking into consideration relevant factors only as they affect the potential risk and return of investments."

7.3 Fiduciary protection

Issues

Employers have responded to a combination of industry marketing, employee demand and a desire to avoid any liability for making investment decisions by offering employees a choice of investments in DC plans. This has not, however, completely assuaged fears of litigation. Plan sponsors remain concerned about what constitutes an appropriate choice of investment options for members, and what form of investment is an appropriate default option for members who do not choose. Concerns also exist regarding the level of investment information, education or advice that the sponsor must or should provide to members.

Fear of exposure to litigation is one reason that pension plans may be wound up, administered poorly or not established in the first place. Some believe that "safe harbour" rules (similar to those that exist in the United States) could provide plan sponsors with sufficient protection from liability to encourage increased occupational pension coverage. The American rules are intended to protect plan sponsors from liability (e.g. from poor investment choices), provided they comply with certain minimum statutory requirements.

The Panel considered the following questions:

- Should protections or immunities from liability (known as "safe harbours") be available to employers operating DC pension plans, and if so, what conditions would have to be satisfied in order for an employer to claim immunity?
- If such protections or immunities were provided, should they be restricted to DC plans, or should they apply generally to all types of plans?
- Do current statutory and common laws provide enough protection?
- Does CAPSA's *Guideline No. 3: Guidelines for Capital Accumulation Plans* provide enough guidance to DC plan administrators on their fiduciary obligations?
- Would safe harbour legislation be overly complicated or burdensome?
- If safe harbour legislation were to be adopted should the provisions be prescriptive or principles-based?

Discussion

There are two main divides among the submissions discussing safe harbour legislation: first, the divide between those favouring safe harbour rules and those opposed to them and second, within those favouring some form of safe harbour, whether such provisions should be prescriptive or principles-based. There is variation among the submitters regarding what criteria or principles should be included, but considerable commonality in the general approach.

Those arguing against safe harbour rules feel there is no need for them, or that they would place too much of the burden on the employee. However, several other considerations are worth noting. First, legislatures, and to an even greater degree, courts, do not like to disentitle people of their common-law rights. There is a strong public policy argument, not limited to pension law, that the existence of a cause of action should be decided by the courts on a case-by-case basis and should not be predetermined. Second, the existence of rules can result in extra levels of governance and require more corporate compliance officers determining whether the law has been met. This, in turn, can result in cases where the rules may be met, but the spirit of the law is violated. Conversely, litigation could be initiated on the basis that a provision or clause was not precisely adhered to.

Another argument against safe harbour legislation is that there has been no Canadian litigation to date on the issue. Even without safe harbour legislation, the Panel is not aware of any case law in Canada relating to investment choice in DC plans, which seems to demonstrate that worries over safe harbour are based on what could potentially happen, not what has happened. In the United States, it is hard to determine whether ERISA protections have reduced litigation; however, it has certainly not stopped it altogether. Instead, it has refocused litigation on the issue of whether or not the relevant safe harbour provision applies in the particular circumstance, i.e. whether the plan members were able to make informed decisions and whether the actions of the plan sponsor were proper and prudent. Such determinations are fact-intensive and must be determined on a case-by-case basis, which means such issues must go to trial. Therefore, the existence of safe harbour legislation does not necessarily mitigate the costs and delays associated with litigation.

Historical data on pension coverage are not conclusive on whether or not the availability of safe harbours has had a positive effect on encouraging new DC plans and increasing pension coverage in the US, compared to Canada where no safe harbour exists.

Stakeholder submissions suggested that there is general consensus that safe harbour protection, if adopted, should apply only to instances where the plan sponsor has adhered to certain minimum requirements, and should not preclude all causes of action. For example, one submission states that plan sponsors should be protected only when:

- compliance with the legislation has been demonstrated; and
- the claimant has failed to demonstrate non-compliance.

Canadian courts may already possess the tools they need (in the form of existing law on trusts and fiduciary duties) to decide in favour of administrators that have met their fiduciary obligations, and not hold them responsible for poor investment results that they could not have reasonably foreseen. While American case law demonstrates that plan sponsors are not protected if their actions were dishonest or misleading, Canadian decisions on pension administration issues appear to be based on similar criteria – even without explicit safe harbour provisions.

The predominant argument in favour of safe harbour rules in the submissions to the Panel was the potential for increased certainty. Threat of litigation is said to be causing some employers to turn away from DC plans; therefore, it is argued, safe harbour protection would increase the number of employers offering DC plans and expand pension coverage. Even if Canadian courts already possess the tools to determine liability, safe harbour legislation may provide plan sponsors with a greater sense of security. Those that support safe harbour believe it could have a positive effect on the number of DC plans offered even if there would be little change to litigation outcomes. However, based on the US experience, safe harbour and the resulting increased certainty could also have the unintended effect of *increasing* the amount of litigation.

If safe harbour provisions were to be adopted, disagreement exists on whether they should be based on prescriptive rules or broad principles.

Stakeholders advocating a more detailed approach want clear guidelines stipulating how many and what kinds of investment options should be presented to employees, how default options should be picked and how information that allows them to make an informed decision should be provided to employees. These submissions argued that such guidance, accompanied by safe harbour provisions, would increase employers' willingness to provide information and/or advice to employees which, in turn, would translate into better investment decisions made by the employees.

The benefits of a prescriptive system are that it would clearly set out what is expected and provide a detailed road-map for plan sponsors to follow. Such a system would provide the greatest degree of certainty, which is what some stakeholders are after. Additionally, there may be advantages to having legislation that is consistent or similar to the ERISA provisions in the United States.

However, rather than an outright adoption of the American guidelines, most submissions favoured using them as a basis or starting point for any Canadian legislation. Possible improvements to the ERISA provisions were outlined in one submission, including the need for greater clarity and precision in such areas as the distinction between what constitutes investment information as opposed to investment advice.

For those favouring a less detailed set of procedures, CAPSA's *Guideline No. 3 – Guidelines for Capital Accumulation Plans* was often mentioned. However, the fact that the guidelines do not have legislative status was a problem for many. This present status only serves to increase uncertainty as employers are unclear whether following these guidelines would provide any legal defence. Some felt these guidelines should be legislated. Others felt the guidelines imposed fiduciary duties on employers without providing any benefits or guarantees and that legislating them would be acceptable only if accompanied by safe harbour provisions.

Submissions favouring principles-based guidelines suggested that the American provisions are overly complex, rigid or detailed, leading to confusion and doing nothing to stimulate the adoption of DC plans. Principles-based provisions would have the advantage of flexibility and would not run the risk of becoming too detailed; however, they may fail to provide the certainty some stakeholders were interested in.

Based on American jurisprudence, if safe harbour legislation were to be adopted, it would be important to consider if a breach of fiduciary duties could be founded on the basis of any or all of the following factors:

- the fees charged by the investment company
- whether, or to what degree, a plan invests in sponsor company stock
- if so, whether and to what extent the company would need to divulge information related to poor performance or expected stock valuation
- whether, or to what degree, there should be limits on the amount of the investment held in a particular company or industry
- who could be considered liable (for example, an actuary who projects incorrectly or a non-fiduciary who is aware of a fiduciary's negligence or lack of due diligence)

The above-noted details would be especially important if prescriptive safe harbour rules were to be implemented.

Panel Perspectives and Recommendations

Many stakeholders believe that the absence of safe harbour protections dissuades employers from setting up DC plans or improving them, or even encourages the closing of such plans. They believe that some form of fiduciary protection that would encourage, or, at a minimum, not discourage the introduction or maintenance of DC plans is desirable.

The Panel considered three main alternatives for safe harbour protection: no safe harbour, safe harbour with prescriptive rules or safe harbour with principles-based provisions.

Not providing safe harbour protection would avoid the potential risk of withdrawing common-law rights. The existing principles of trust and fiduciary law would continue to prevail, and judges would maintain the discretion to decide on a case-by-case basis. However this approach would do nothing to address stakeholder concerns about uncertainty and plan coverage.

Safe harbour protection based on prescriptive rules, similar to those found in the United States, would provide a road map for plan sponsors and members. Some say that this would increase the number of DC plans. However the American experience shows that this approach would not necessarily forestall litigation, and it runs the risk of being overly-detailed or complex while disentitling a class of litigants. The Panel believes that incorporating a tick-box approach, as would result from a prescriptive approach, would not meet our objective – to protect fiduciaries that make appropriate decisions that, in hindsight, achieved less than desired results.

Principles-based safe harbour protection would offer more flexibility than prescriptive rules, however, it would provide less certainty and would still run the risk of disentitling a class of litigants. On the other hand, it could help to increase the number of DC plans and could be designed to be more even-handed by including all types of pension plans, rather than being restricted to DC plans.

Having considered the US experience and the existing common law, the Panel is not convinced that exculpatory safe harbour legislation similar to the US provisions would meet our objectives. However, given the significant support of stakeholders for safe harbours, we considered whether another form of protection might be more appropriate, and to whom any such protection should apply.

In developing our recommendations on this issue, the Panel focused on the following objectives:

- maintaining and promoting pension plans in general
- giving plan sponsors more confidence in providing a member-invested DC plan
- raising the quality of pension plans by ensuring that the plan sponsor is not afraid to "do the right thing"
- ensuring that proper options, defaults and education are made available to plan members
- avoiding "under-regulation" nominally in the interests of encouraging coverage, which would not serve either plan sponsors or members well

The Panel believes that exculpatory safe harbours weaken benefit security, and should be avoided. While the intent would be to develop minimum criteria before safe harbour protection became available, we believe it would be very difficult to avoid weakening, or being seen by some to weaken good practice and governance. Legislating strong governance requirements, which might avoid this risk, might be considered by others as "the last nail in the coffin" due to increased costs and governance burdens. This result would be counter-productive, and contrary to the Panel's objectives.

The Panel believes that the legislation should provide clear guidance on what constitutes appropriate due diligence for sponsors, not only in respect of offering investment choice, but on governance in general. Compliance with legislated governance requirements should offer the sponsor a defence from legal action. This approach would provide an incentive for sponsors to incorporate better governance processes and would give fiduciaries some comfort that if they can demonstrate good governance practices they are generally protected.

In our view, this approach would not relax standards for fiduciaries, but would merely clarify existing law, as it is likely that the courts would so rule in any event based on the common law related to fiduciary duty. This principle would be akin to how the "business judgment rule" operates in the corporate context. The business judgment rule is a common law extension or interpretation of how directors' statutory fiduciary obligations should be carried out that has been accepted by the Supreme Court of Canada.[49] That rule

[49] *Peoples Department Stores Inc. (Trustee of)* v. *Wise*, [2004] 3 S.C.R. 461.

generally applies to protect the decisions of corporate directors from “second guessing” to the extent that directors are scrupulous in their deliberations and demonstrate diligence in arriving at their decisions. Courts are entitled to consider the content of decisions and how they were reached. The rule recognizes that not all decisions will result in perfect outcomes, but that those decisions should not be subject to question where they have been made through reasonable and diligent processes. The business judgment rule offers a defence if the decisions were made:

- in good faith;
- on an informed basis (including obtaining expert advice, where appropriate);
- in the interests of the corporation; and
- in the absence of conflicts of interests.

The applicability of a judgment rule in the pensions context (which we will refer to as a “pension judgment rule”) has strong appeal. As with corporate directors, the pension plan administrator’s fiduciary obligations emanate from the applicable statute. The administrator makes numerous decisions affecting plan beneficiaries, as directors do affecting shareholders, that could be subject to question by others with the benefit of hindsight. As in the corporate context, the Panel believes that the emphasis should be on encouraging plan fiduciaries to follow good practices and processes, without having to live in fear that every decision could lead to litigation and potential liability even where prudence and diligence have been exercised in the decision-making.

In the Panel's view, it would also be appropriate for pension standards legislation to specifically address areas where there is currently some doubt as to the appropriateness of particular pension plan design features. For example, auto-enrolment (the automatic enrolment of members), auto-escalation (the automatic increase in plan contributions over time) and no investment choice (investments are managed by the plan administrator and members have no discretion as to investment options) are plan features that may raise doubts regarding the obligations of governing fiduciaries. Auto-enrolment of existing employees who are not currently members of their employer's pension plan, and auto-escalation of their contributions, may not currently be permissible, unless specifically permitted by other legislation, due to restrictions in employment standards legislation in our two provinces on an employer's ability to make deductions from an employee's earnings. (We note that no such doubt should exist regarding the choice of a default investment option, as the CAP Guidelines currently provide adequate guidance on the question of a default investment choice that is not risk-free.) The Panel believes that such design elements, as components of a properly communicated "pension deal", should be specifically permitted, subject, of course, to the proper exercise of the administrator's overriding fiduciary obligations in implementing such a feature.

The Panel recommends that:

7.3-A Elements of the CAP Guidelines that do not relate to investment choice should be legislated to apply equally to all plans, including those that do not offer member investment choice. (See Recommendation 7.1-A above)

7.3-B The legislation should explicitly state that "auto-enrolment" and "auto-escalation" are permitted and are not actionable in and of themselves.

7.3-C The provision of one investment vehicle only should not, in itself, be actionable unless the selection has not been made and monitored with due diligence.

7.3-D Plan fiduciaries who can demonstrate that they are compliant with the requirements of a "pension judgment rule" in the legislation should have a statutory defence against claims in respect of their decisions in the same manner that corporate directors are protected by the business judgment rule.

8.0 Funding and Benefit Security – Overview

An important part of our mandate was to address benefit security in DB pension plans. The central provisions in the pension standards legislation addressing benefit security are minimum funding rules. Our discussion paper highlighted the issues involved with the following questions:

- Should minimum funding rules continue to address both going-concern and solvency liabilities or should the focus be solely on solvency funding?
- Should the minimum funding rules take into account the financial health of the employer sponsoring a DB plan, and if so, how?
- Should minimum funding rules take into account the risk profile (asset / liability mismatch and asset mix) of the plan and, if so, how?
- Should each DB plan be required to have a funding policy? If so, should it be a regulatory filing requirement?
- Is "one-size-fits-all" legislation adequate – or should there be different rules for different pension models? If so, how should they vary?
- Are there compromise solutions to the conflict between risk-reward asymmetry and benefit security in DB plans?
- How can the conflict between short-term benefit security and long-term contribution predictability for DB plans be best addressed?

Our terms of reference linked minimum funding rules directly with ownership of surplus. Minimum funding and surplus assets are the opposite ends of a continuum of pension funding, but they are linked because many argue that uncertainty about ownership of surplus discourages employers from funding DB plans beyond the legislated minimums. Current minimum funding rules do not require that pension plans be fully funded at all times, which some have argued provides inadequate benefit security, but any attempt to raise the bar without dealing with the surplus ownership issue is likely to meet resistance from employers.

The standards themselves have come into question in recent years for several reasons. Solvency funding standards, which came into force across Canada in the mid-1980s and were adopted in British Columbia in the original PBSA provisions in the early 1990s, have come under fire from various sources.

Employers who sponsor DB plans have criticized the rules in recent years for producing high and volatile funding requirements that can result in surpluses. These funding requirements have sometimes reached their zenith at times when employers are least able to increase their contributions – a situation which, in its most extreme ramification, could result in a company becoming insolvent by trying to meet obligations designed to protect plan members from company insolvency. Such a situation has occurred twice in the current decade – once in the early years of the decade and again at the time this report is being written. This has often been characterized as the "Catch-22" of solvency funding.

One of the chief sources of opposition to solvency funding rules has been a category of plans that have been thought of as DB plans, known variously as "specified multi-employer pension plans" (Alberta), "multi-employer pension plans," "target benefit plans" or "negotiated cost defined benefit plans." They argue that the funding standard, because it is based on a plan wind-up scenario, is inappropriate for these plans because they are unlikely to wind up and because of the volatility of the requirements. However, the "other side of the coin" – surplus ownership – is not an issue in these plans because surpluses generally are used to benefit members.

It is clear to the Panel that what would constitute appropriate funding rules depends critically on the nature of the "pension deal" and on the risks associated with different types of "pension deal". It is also clear that addressing surplus ownership uncertainty is viewed by many DB plan sponsors as a "quid pro quo" for any change in funding rules designed to enhance benefit security. Finally, we asked ourselves whether a set of hard-and-fast standards is effective in an uncertain and variable economic environment. Consequently, we have broken this section into three main parts:

- minimum funding rules and surplus ownership in "traditional" DB plans – or plans that are characterized by specified or guaranteed benefits and contributions that may vary, whether these plans are sponsored by one or many employers and whether (as in, for example, many public sector plans) employees are effectively joint sponsors and can have their contributions vary to cover funding shortfalls
- the special case of what we are calling "specified contribution target benefit plans" (SCTBs) – plans that are characterized by specified or fixed contributions and benefits that may vary, whether they are sponsored by one or many employers
- temporary relief measures

8.1 Defined benefit plan funding rules and surplus ownership

This section will make recommendations on DB pension plan funding and will include discussions of surplus ownership and contribution holidays. Our recommendations take into consideration the Objectives and Principles noted earlier in this Report.

The recommendations in this section apply specifically to "traditional" DB plans, both single employer and multi-unit arrangements. Funding issues relating to SCTBs are considered in Section 8.2.

Issues

- What is the nature of the DB promise: is it like insurance or something less secure?
- Is there a long-term future for "traditional" DB plans or are we at best presiding over a legacy system that has to be wound down safely with minimal risk of loss of benefits?
- Should minimum funding rules continue to address both going-concern and solvency status of DB plans, or should minimum standards shift entirely to a solvency focus?
- If going-concern standards are retained, should there be changes in either the range of assumptions, margins for adverse deviation, or amortization period?
- Should the solvency rules be amended and, if so, how:
  - Should 100 percent solvency continue to be the target, or something less?
  - Should the solvency test be a pure wind-up calculation (no smoothing)?
  - Should a "solvency current service cost" be determined?
  - How long should the amortization period for deficiencies be, and should the length be contingent on the characteristics of the deficiency?
  - If more stringent rules are to be adopted, should there be a transitional period and, if so, how long?
  - If a reserve (>100 percent solvency) is to be accumulated, how much and how should it be accumulated?
- Should separate solvency accounts be permitted?
- Should letters of credit be a permanently permitted feature of solvency funding?
- Are there other alternative financing vehicles that should be permitted for solvency funding (third-party risk insurance and other covenants that provide benefit security)?
- To what extent should the statute address the surplus issues arising under the common law?
- Should there be differences in approaches during the life of a plan vs. at termination?
- What rules should apply to contribution holidays?
- Should surplus withdrawals be permitted? If so, should there be a maximum withdrawal? Is there a need for a "cushion"?
- Are there related proposals that might defuse the issues?

Discussion

One of the fundamental purposes of pension standards legislation historically has been to protect benefit security for members of DB pension plans. Current pension standards attempt to address this objective by requiring pre-funding of benefits with mandatory amortization of deficiencies and regular reporting to the regulator on the funded status of plans on both going-concern and solvency bases.

In the first generation of pension standards legislation, only the ability of the plan to meet its obligations assuming it continues to operate ("going-concern" status) was measured, and only going-concern deficiencies were required to be eliminated by being funded by amortization payments over a specific period of time. Deficiencies arising from benefit improvements were required to be amortized over 15 years and experience deficiencies (shortfalls compared with the previous valuation's assumptions) had to be amortized over five years.

The second (current) generation of legislation replaced accelerated funding of experience deficiencies with the requirement to test for and fund for "solvency", that is, the plan's ability to deliver promised benefits in the event of plan termination. To recognize the volatile nature of the assumptions used to calculate solvency status, the legislation in several provinces permits some adjustments from a strictly wind-up status calculation in measuring and rectifying the deficiencies.

More recently, many jurisdictions, including Alberta and British Columbia, have added the requirement for an employer terminating a plan voluntarily (i.e. in circumstances other than business insolvency) to amortize any solvency deficiency existing at plan termination over not more than five years.[50]

There is not much argument that termination of a plan due to the insolvency of an employer poses a benefit security risk, and that solvency standards generally address this risk. However, several aspects of the financial and legal environment of the last few years have led to questions about whether the current regime is adequate for the future:

- Solvency liabilities have become very high, in many cases higher than going-concern liabilities, in a low interest rate environment.
- Even the current requirement to fund to a point-in-time solvency estimate might not be sufficient to provide the required benefit security, depending on any asset-liability mismatch that may exist.
- Many in the actuarial profession have begun to question whether a going-concern valuation that relies on unrealized estimated equity returns is an adequate measure of the plan's ability to meet its obligations. Some have extended this argument to advocate the creation of reserve accounts to mitigate the losses that can sometimes

[50] EPPA s. 73; PBSA s. 51.

occur with investments in riskier asset classes, often with reference to the plan's risk characteristics.

- Due to legal issues about surplus ownership, employers who sponsor plans have tended to fund only to the statutory minimums. Because of the so-called "asymmetry risk," where surpluses generally are to be shared with plan members while deficits are the plan sponsor's responsibility, sponsors have no incentive to build a surplus cushion as a protection against adverse market conditions, resulting in lower benefit security than has traditionally been considered desirable for a DB promise. This "risk," among other factors, has led some DB sponsors to either wind up or freeze their pension plan to avoid or minimize its impact. (See also Section 8.1.2 below, for further discussion of surplus ownership issues.)
- It has been said that funding rules that require plan sponsors to keep enough money in a pension plan to eliminate completely the risk of loss of benefits on insolvency can make these plans unaffordable. The assertion is that, while it might be theoretically desirable to maximize benefit security, the financial reality is that legislation that attempts to further increase the security of members' benefits will likely hasten the demise of voluntary DB pension plans. This reflects the challenge before the Panel in recommending DB funding rules: to find the right balance between the need for benefit security and the importance of encouraging pension coverage for the future.

Clearly, in a DB plan, the issues of surplus ownership and minimum funding rules are linked because of financial and legal considerations for the employer or employers who sponsor the plan and are responsible for funding deficits. Therefore, we have structured this section to examine these issues and make recommendations as a package.

We will address the overall issue as comprising three questions:

- How should liabilities be valued and the funded status of a plan be determined?
- What standards should exist for correcting deficiencies?
- How can funding standards be balanced with employers' concerns about surplus ownership?

We have crafted recommendations with the objective of strengthening and simplifying funding requirements while reducing disincentives to plan continuation and proper plan funding.

8.1.1 Defined benefit funding rules

How to value liabilities

It is important to be clear on what the DB funding promise means (equivalent to insurance or something less) – or, if more than one type of arrangement is to be allowed, vis-à-vis the level of benefit security, the legislated standards should allow such distinctions to be made and tailor provisions appropriately. As the Panel is recommending different funding approaches for different plan types with different promises, funding for SCTB plans is not included in this section.

A strong component of the pension industry favours embracing the principles of financial economics.[51] This school of thought holds that, among other things, funders should be, economically speaking, indifferent as to whether their plan is funded by matching assets to liabilities or taking risks in the form of mismatches. The greater the risk, the greater the variability in returns: there are more chances for both higher (equity risk premium) and lower returns than would be yielded from lower risk fixed income or interest-bearing investments. Therefore, the greater the risk, the higher the contingency reserve should be to anticipate negative variance. This does not mean that those making funding decisions could or should be forced into a matching strategy.

The essence of the debate, though, is whether pension funding standards should allow valuations of plans to take credit for the equity risk premium before it materializes. In calculating the plan's liabilities and estimating whether the plan's assets will be sufficient to cover liabilities as they become due, the actuary must estimate the future investment returns on assets. This rate of return is incorporated into the "discount rate" that actuaries use to calculate the present value of liabilities – the higher the assumed rate of return, the lower the current liability. Financial economists contend that using a discount rate that assumes there will be a positive return for risk "counts the chickens before they're hatched" and understates the true liability. Financial economists would say a risk-free rate of return should be assumed and, if an equity risk premium is realized, it will be recognized in subsequent valuations as an experience gain. This would be a more conservative approach to estimating funding requirements than has been practiced over the past several years.

With a few exceptions, there is growing support for focusing minimum standards on solvency, and making the test for solvency as close to the true cost of a plan wind-up as possible. The motivation is transparency and having the clearest picture possible for regulators, plan sponsors and plan members.

This raises the issue of what minimum standards should apply to wind-up settlements. The general standard has been that upon plan termination, it is assumed everybody is vested and everybody gets benefits calculated at their optimum value (e.g. earliest possible retirement.) At least for pensions in pay, and often for deferred vested members eligible for immediate pensions, the benefits may be valued at the price of providing an annuity equivalent to the earned defined benefit. For others, the standard would be the normal termination benefit (commuted value). These technicalities can make a huge difference in the total wind-up liability and, harking back to a key point, the answers depend on what is assumed to be the DB promise.

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[51] *Financial Economics and Canadian Pension Valuations*, Canadian Institute of Actuaries Task Force on Financial Economics, September 2006.

Standards for correcting deficiencies

The test and the remedy are two separate issues. If there is a firm standard for valuing liabilities, allowing very little flexibility, the relief could be built into the standards for correcting deficiencies. First, there is the question of whether deficiencies are allowed to exist for any length of time.

Although there is a spectrum of views on these subjects, most stakeholders combine any recommendations for changes, especially changes that would tighten funding standards, with caveats:

- Change should be contingent on finding a satisfactory solution to the "asymmetry" issue – otherwise the result would be a further retreat from DB plan sponsorship (see discussion in Section 8.1.2 below).
- There is a need for more regulatory resources and expertise if more complex standards are adopted.
- Federal tax rules would have to be relaxed to allow the maintenance of a funding cushion above the 10 percent margin currently permitted (see further commentary in Section 10.1 below).

At the opposite end of the spectrum, some stakeholders with a primary interest in benefit security advocate that pension plans should be fully funded on a solvency basis at all times.

Here, options range from the contention that "almost all of the time" is a high enough level of benefit security, to those who believe there should be at least 100 percent funding, with contingency reserves, especially related to the plan's risk factors. A side issue is whether the standard should be based on some specific level which would be compared against the actuary's (deterministic) valuation, or whether it should be based on a range of possible values as is used in stochastic modeling (a probabilistic statement).

A number of stakeholders advocate allowing the establishment of a separate fund, which the Panel is calling a "pension security fund" (PSF), that would hold any solvency payments required and would be accessible to the employer if not required to meet solvency liabilities. This approach is frequently recommended in conjunction with the establishment of a target solvency margin to enhance benefit security. The level of the margin could 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.

Balancing funding standards and surplus concerns

Finally, there is the biggest consideration of all: how to balance minimum funding standards with the objective of ensuring at least the continuation, if not a resurgence of DB arrangements. Data the Panel received from the Alberta and British Columbia superintendents indicate a continuing decline in DB coverage in both provinces: the number of DB plans has decreased in Alberta by over 60 percent over the past 20 years, and by about 40 percent in British Columbia since 1993 (although approximately one-third of the decline arises from merged or transferred plans).

Over and above the "asymmetry issue", which is discussed in Section 8.1.2 below, funding issues can add to the discontinuance of traditional DB pension plans. Overly stringent funding rules – especially combined with sponsors' fears that they will not be able to access the surpluses that would be more apt to arise – would likely discourage the formation and maintenance of DB plans, hastening the DB demise.

Panel Perspectives and Recommendations

A balanced view is needed to resolve the issues around funding and surplus since the Panel's objectives include potentially conflicting desired outcomes: both to facilitate coverage of workers in occupational pension plans while also to enhance the security of the pension promise. It is important that the DB promise be secured, but it is also important that the pension standards be structured so that plan sponsors are willing to establish and maintain these plans (i.e. that security and coverage objectives both be considered). In the Panel's view:

- Going-concern valuations should continue in order to provide the longer-term focus appropriate for ongoing plans. They should be based on the plan's funding policy, with the actuarial profession's "accepted actuarial practice" providing confidence in the adequacy of the approach. Going-concern valuations would also be essential if a pension security fund (see below) is permitted to address ambiguities about surplus ownership. The Panel believes that the current regulation of going-concern funding (e.g. 15-year amortization of experience deficiencies) should continue.
- An appropriate solvency valuation, without excess complexity that would seriously add to costs, should continue to be required in order to provide reasonable benefit security to plan beneficiaries. While 100 percent security cannot be guaranteed, the proposed solvency funding regulations should, in most circumstances, secure the promise.
- The proposed requirements for this solvency valuation include provisions that generally reflect the benefits that would be paid on plan wind-up. A requirement for annual solvency valuations when there is less than a 10 percent "cushion" would assist in keeping a careful watch on the solvency status.

- Some have suggested that the solvency amortization period for financially healthy sponsors should be extended to 10 years to assist in moderating contribution volatility while not substantially reducing benefit security. However, extending the amortization period for credit-worthy companies was considered and rejected by the Panel because there did not seem to be a satisfactory way for the regulator to measure a sponsor's financial health and willingness to meet its obligations.
- There is merit in permitting the continued use of letters of credit by credit-worthy companies to manage volatility and provide contingent assets through a third party based on that party's assessment of the financial health of the sponsor. PSFs are also being recommended to reduce sponsor concern about solvency funding and trapped capital (see below).

The Panel recommends that

8.1.1-A Pension standards should continue to require both solvency and going-concern valuations, with reasonable requirements that protect benefit security while not being overly onerous for sponsors, as further described below:

Going-concern funding requirements

8.1.1-B Current going-concern funding rules should continue to apply and be determined by the plan actuary and the plan sponsor, based on the plan's funding policy (see also Section 7.1 "Governance standards" above), actuarial standards of practice and regulatory requirements.

Solvency funding requirements

8.1.1-C Solvency funding rules should be developed on the following bases:

- **Asset valuations should be based on pure market measures (with no smoothing of assets).**
- **Liability valuations should be prepared on a pure wind-up basis, assuming annuity purchases for persons receiving or eligible for immediate pensions and termination (commuted) values otherwise. Benefits provided at the discretion of the administrator/trustee/plan sponsor should not be included in the valuation.**
- **Assumptions should be based on the actuarial standards for calculating commuted values that would be adopted in the legislation. (See also Recommendation 6.1-G above.) No additional margins or provisions for adverse deviation (PfADs) should be required, other than those already implicit in the commuted value.**
- **Amortization of any solvency deficiency should continue to be over five years; however, assets to satisfy the deficiency**

could include letters of credit or assets in a PSF. (See Recommendations 8.1.2-A and 8.1.2-C below.)

- **Solvency valuations should be required annually unless, at any valuation, plan solvency was 110 percent or greater, in which case the next valuation would not be required for three years.**

8.1.2 Ownership and use of surplus

Discussion

Who "owns" any surplus that may exist in a pension plan, or who may be entitled to use or withdraw surplus and when, has been the subject of considerable controversy; this issue, as noted above, has an impact on both benefit security and pension coverage. Although the question of surplus ownership and utilization in a DB plan is a controversial one, there is general agreement that the party who bears the risks and burdens of financing the plan should be entitled to it. The disagreement is over the question of who actually bears these risks and burdens.

The asymmetry argument

From the point of view of employers who sponsor plans, there is a mismatch of risks and rewards between their pension obligations and entitlements. Most Canadian jurisdictions, including British Columbia and Alberta, require the plan sponsor to make up unfunded liabilities and solvency deficiencies. Yet, if a surplus accumulates in the plan, there is no certainty that the employer will be entitled to any portion of it. This problem for sponsors is referred to as "asymmetry".

The asymmetry argument can be summarized as follows:

- Employers and employees negotiate compensation packages comprised of both wage and non-wage benefits; in that negotiation, wages may be forgone in favour of pensions and other non-wage benefits. Employees offer the forgone wages in return for the sponsor's promise to pay a fixed pension benefit.
- Wages forgone in order to receive future pension benefits are analogous to premiums paid for an annuity purchased from an insurance company. Similarly, the employer's promise is analogous to that of the insurance company – to pay the fixed benefits promised by the plan.
- In a DB plan, the amount of the contributions required to provide the promised benefit are calculated on the basis of a number of economic and demographic assumptions.
- If the assumptions used to calculate the contributions required were too optimistic, the plan would experience deficits. The obligation to make special payments to eliminate any deficit falls on the employer.

- Conversely, if the assumptions were too conservative, the plan would accumulate surplus assets. As the employer bears all the burdens and risks associated with ongoing funding requirements, including the payments that lead to the development of surplus, it is the employer that should be entitled to any surpluses. Yet, in accordance with plan provisions or the common law of trusts, the employer may not be legally entitled to the surpluses.
- As the solvency calculations depend on highly variable economic assumptions such as interest rates, pension funds with deficiencies one day may well have surpluses the next.
- The solvency funding rules require employers' scarce resources to be diverted from other capital priorities (e.g. plant expansion or modernization), with the potential that any surpluses that may arise could ultimately be "trapped" in the plans. Uncertainty as to the ultimate entitlement to surpluses is a disincentive to employers funding pension plans to any level beyond the minimum required.

The deferred wages argument

On the other hand, some employee groups argue that employer contributions really belong to the employees and, therefore, it is the employees that generally bear any burden or risk associated with surplus assets in pension funds. They view any employer contribution as simply "deferred wages" belonging, in substance, to the employees. In contrast to the asymmetry view, the deferred wage argument sees the employers' contributions as the employees' own investments, leading to the conclusion that the pension fund, including all of its investment returns, belongs to the employees. In effect, this view suggests that a DB plan is actually a DC plan in disguise.

The deferred wages argument can be summarized as follows:

- Employers and employees negotiate compensation packages comprised of both wage and non-wage benefits. Non-wage benefits are "bought" by employees by giving up wages equal in value to the employers' cost of providing the benefits.
- Employer pension contributions are, therefore, in substance, deferred wages of the employee; the pension fund, comprised entirely of deferred wages of the employees and associated investment earnings, belongs to the employees.
- The obligation to eliminate any deficit falls initially on the employer, who then shifts the burden of any such payments to employees by reducing wages or other non-wage benefits. Therefore employer contributions, even if they are in the form of special payments, are also actually deferred wages of the employees.
- As all contributions to the plan are, in substance, employee contributions, it is the employees that bear all of the burden and risk associated with the ongoing funding requirements including the foregone wages that led to the development of any surplus, and, therefore the employees should be entitled to it.

The deferred wages theory turns on the precept that any increase in employer contributions is reflected as a decrease in employee wages or non-wage benefits on a dollar-for-dollar basis. While there is some theoretical support for this,[52] the extent to which employees forgo wages in any given circumstance cannot be determined with certainty, and no generalizations can be made. Even if employers do sometimes reduce wages to offset pension costs, it is not likely that this occurs immediately – it is far more likely that future workers, not current plan members, would experience the impacts of any such wage adjustments. It is at least equally likely that, rather than offsetting the additional costs through wage reductions, the employer shifts the burden to customers in the form of price increases, compensates by reducing other types of costs or bears the burden directly by reducing profits.

Aside from these economic arguments about who owns the surplus, employer and employee groups disagree about the role that "asymmetry" and surplus ownership issues have played in affecting employer behaviour and, as a result, the funded status of the plan. Employee groups argue that, in better times (high interest rates and greater investment return), employers used their right to take contribution holidays to reduce payments into the plan, thereby improving the company's bottom line. Some take the view that this behaviour by employers increased risks to employees, whose benefits may have been jeopardized, especially where it later transpires that the employer becomes bankrupt. They believe that employees truly bear the ultimate risk, in that if the employer becomes insolvent and the plan is also insolvent, the members will see their benefits reduced.

A further argument hinging on the power of the employer is that the creation of "surpluses" is to some extent within the power of the employer because of its influence over the choice of actuarial assumptions. If more conservative assumptions had been used, a "surplus" might not have existed.

On the other hand, employers have countered that, in some cases, their contribution holidays were forced on them by tax rules that limit the amount of surplus that can accumulate in a plan. Others note that fears of "trapped capital" have encouraged them to take holidays whenever possible.

Trust law

Much of the law relating to surplus entitlement has evolved from the common law of trusts and the content of plan trust agreements. The development of the common law, along with historical federal tax registration requirements requiring employer contributions to be irrevocable, has resulted in two distinct legal frameworks for pension plans.

[52] See, for example, *Arguments about Asymmetry of Risks and Rewards and Deferred Wages in Pension Plans* by James Wooten for the Ontario Expert Commission on Pensions.

While investment annuity contracts with insurance companies or trust agreements with institutional custodial trustees were both acceptable vehicles to meet the federal requirement for “irrevocability”, trust agreements were often more economical and became the preferred choice of many sponsors. Although this federal requirement was relaxed in the late 1960s and early 1970s, it was replaced with an explicit requirement in 1981 for DB plans to include a provision that surplus may be refunded to employers upon termination of a plan. Therefore, it is generally in pre-1981 plans, or newer plans that have absorbed older ones, that the problem of surplus ownership seems to arise.

Pension security funds

Many have suggested that pension standards legislation should be amended to override trust law on the matter of surplus entitlement. However, attempting to override the terms of an existing plan or trust could be considered unfairly retracting accrued beneficiary rights. To address the legacy issue while avoiding retroactive reductions, it has been proposed that a new type of pension vehicle could be considered. The proposed vehicle has been referred to as a “solvency account”, “contingency reserve fund” or “pension security fund” (PSF). It has been suggested that such a fund could remove trapped capital fears of sponsors so that improved benefit security and reduced contribution volatility would follow.

According to one suggested model, once the plan is 100 percent funded on a going-concern basis, additional employer contributions, whether required for solvency funding or paid voluntarily, would be deposited into the PSF, and could be accessed by the sponsor of an ongoing plan only in circumstances where the account became larger than necessary for the health of the plan. Another approach would have all solvency-related payments deposited into the PSF, regardless of the going-concern status.

In these suggested models, the PSF would be held separate from the employer’s assets and would be protected from creditors like any other pension fund. Contributions to the account would be tax deductible, and withdrawals would be taxable. Upon settlement of all plan benefits the remaining assets would revert to the plan sponsor.

Letters of credit

As an alternative or addition to PSFs, proponents of the asymmetry argument have suggested that allowing sponsors to use letters of credit to fund solvency deficiencies would help to address the problem. Although letters of credit are an expensive financing vehicle, for which only very financially sound sponsors would likely qualify, they would mitigate the asymmetry problem by allowing sponsors to finance deficiencies without the risk of “trapping” capital in pension funds.

Alberta and British Columbia currently allow letters of credit to be used to fund solvency deficiencies under certain circumstances.

Retroactive or prospective solution

Potential resolutions of the surplus ownership problem are evolving as stakeholders continue to build on the ideas of contract versus trust law, solvency accounts and improved clarity in trust documents for any new plans. While it may be possible to address the issues prospectively, the real question is what to do with the "legacy issue": existing plans governed by problematic trust language, with no provisions on the topic of surplus, or for which the chain of documents over the years has been lost, leaving the sponsor's authority to remove surplus or to make amendments unknown. At least one stakeholder believes that there is really no point to a prospective-only fix, because the real problem relates to the past. The few new DB plans being established are being designed with unequivocal provisions regarding surplus ownership, and both the British Columbia and Alberta statutes require that new plans explicitly address the ownership of surplus for ongoing and terminated plans.

On one hand, it would seem ideal to some plan sponsors to address the problem on a retroactive basis, simply overriding both common law and problematic trust language with clear legislation on the matter – ensuring that all pension plans are subject to contract law. On the other hand, a retroactive override may be seen by workers as arbitrarily extinguishing rights to which they were previously entitled. It is likely that labour groups would challenge a retroactive legislative override and, regardless of whether there is a legal basis for such a challenge, this would be an unfavourable result for everyone.

Resolving the problem on a prospective basis would require legislation allowing sponsors to "freeze" benefit accruals in existing plans and start new plans with clear allocations of any potential surplus. The old plans would be closed to new current service contributions, and accruals of service and recognition of salary increases would cease, but valuations would continue to be performed and deficits or surpluses could still arise – and would be dealt with in accordance with their historical provisions. Benefits would be paid from the old funds until all liabilities are discharged. However, opening the new plan would not extinguish employees' rights to entitlements such as vesting or early retirement based on their previous accruals. Of course, the new legislation would also need to provide that the old plan would not be terminated, notwithstanding that there would be no further accruals under it. No particular legislation would be required to address the surplus issue for the new plans, because they would be established with unambiguous provisions in that regard.

Regardless of the solution adopted, it is important to keep in mind that this may be a more limited problem than it might appear, given the amount of attention the issue has received in courts of law and of public opinion. In particular, it may be a more limited problem in British Columbia and Alberta than in Ontario or elsewhere because of legislation enacted in the late 1980s and early 1990s stimulating plan sponsors to add provisions or fix problematic ones. Nonetheless, for those DB plans where there is doubt about surplus ownership, a solution to the issue is important for all stakeholders involved with such plans.

Surplus withdrawal

Pension standards in both British Columbia and Alberta require pension plan documents to set out how surplus is to be allocated in both an ongoing plan and a terminated plan.[53] Both British Columbia and Alberta allow surplus assets in either an ongoing plan or a terminated one to be transferred to the employer if the plan expressly provides for such a transfer. If the plan does not clearly provide for it, transfer of surplus assets to the employer is still permitted if the employer can demonstrate that two-thirds of the members consent to the withdrawal. The windup of a DB plan that is in a significant surplus position can be especially complex if the ownership and distribution of the plan's surplus have not been clearly addressed by the plan. Further complications arise if the plan has members in more than one province, and the rules on surplus distribution differ between provinces.

Contribution holidays

Because contribution holidays effectively absorb surplus assets, the controversy on this issue is closely linked to that of surplus. Can an employer take a contribution holiday (effectively using surplus assets to replace employer contributions otherwise required) if the employer is not entitled to the surplus on windup?

A "contribution holiday" is a period of time during which employer contributions are not remitted to a pension plan due to the existence of surplus in the plan. Most pension standards legislation across Canada permits employers to take contribution holidays subject to certain conditions. Much of the debate on the topic of contribution holidays centres on the same questions as those that arise in connection with the issue of surplus entitlement. Supporters of the "asymmetry argument" generally recommend that sponsors be allowed to take contribution holidays, while those in the "deferred wages" camp generally believe that employers should be restricted or completely precluded from taking contribution holidays.

It should be noted that Alberta and British Columbia differ when determining whether a contribution holiday should be allowed:

- In British Columbia, an employer may take a contribution holiday only if the plan has surplus assets and specifically provides for them; however, such a holiday must not reduce surplus assets to less than five percent of the value of the liabilities under the plan determined as of the previous review date, and surplus assets over the five percent limit must be amortized over a period of five years beginning at the commencement of the contribution holiday. Written notice to members, former members, trade unions, any advisory committee and the superintendent is required.

[53] EPPA s. 28(1)(g); PBSA s. 24(1)(d) and (g)

The administrator must also confirm that the plan will continue to meet the solvency requirements after taking the contribution holiday.[54]

- In Alberta, excess assets may be used to reduce employer contributions unless the plan specifically prohibits contribution holidays. Contribution holidays are not permitted in respect of employer contributions relating to a solvency deficiency. There are no notification provisions. (In most Canadian jurisdictions, the term "surplus assets" is defined to mean the excess of the value of plan assets over plan liabilities, and is used in the context of both ongoing and terminated plans. In Alberta, the term "surplus assets" is used only in the context of plans that are being wound up and a separate term, "excess assets," is used to specifically address pension plans that are not being wound up.)[55]

If contribution holidays are to be allowed, there is general agreement that they should be restricted to the extent required to ensure that the financial health of the plan is not jeopardized. Examples of measures designed to protect the health of the plan where contribution holidays are contemplated are provisions requiring:

- that a surplus margin be left in the plan;
- that the accessible surplus (in excess of the margin) be amortized over a number of years; and
- that the amount of accessible surplus and the required amortization be recalculated at the date of each valuation.

Requiring a surplus margin (>100 percent solvency ratio) to remain in the plan after the contribution holiday has been taken provides additional protection in case of unexpected adverse conditions, is consistent with the general approach to surplus withdrawals in an ongoing plan, and encourages funding beyond minimum requirements. It has been suggested that the margin should be proportional to the mismatch of assets to liabilities in the plan, e.g. a plan with more equity exposure should have a higher threshold. Requiring that the surplus be amortized over a period of a number of years, and requiring a recalculation at the next valuation date imposes additional prudence, and helps to ensure that the contribution holiday does not continue in circumstances where the plan is no longer adequately funded.

It has also been noted that the triennial valuation cycle presents additional risks where employers are relying on older valuations to support a contribution holiday. While a requirement for a shorter valuation cycle would impose additional costs on the plan, a simpler method of confirming the financial health of a plan may be helpful when considering a contribution holiday. For example, a form of simplified opinion could be developed that updates the financial position annually based on changes in long-term interest rates and actual investment returns.

[54] PBSR s. 36
[55] EPPA s. 1; EPPR s. 48(11)

The federal *Income Tax Act* limits employer pension contributions and forces contribution holidays by limiting the amount of surplus that may be held in a plan (see discussion and recommendations in Section 10.1 below).

Panel Perspectives and Recommendations

The Panel believes that the deferred wages argument is not persuasive for ownership of surplus in plans where sponsors are responsible for deficits (although it is obviously relevant where contributions are negotiated as may be the case with SCTB plans or where employees explicitly share the obligation for funding deficiencies on an ongoing basis).

Accordingly, our recommendations do not adopt the deferred wages approach but are nonetheless intended to improve benefit security (i.e. support the pension promise) while encouraging the continuation of DB pension plans.

The Panel is of the view that contribution holidays and surplus withdrawals should be permitted, but only when reasonable funding adequacy is demonstrated. Cushions and an amortization period would support the desire for an adequate level of benefit security. The amortization period is designed to protect the plan from over-withdrawal in the event of rapid fluctuations in funding status and also addresses concerns that employers might use the plan as a "tax management" device.

A number of approaches for dealing with trust law issues related to surplus are recommended, including using a third party letter of credit for solvency funding, establishing a PSF without "legacy" concerns to hold solvency assets, and permitting "ring-fencing"[56] the past while creating a new "wrap-around" plan under contract law for the future. Fiduciary duties would continue to apply to the new plan, even though it would be subject to contract rather than trust law. These approaches are intended to give plan sponsors choices that will make DB plans more appealing to them while removing the argument that existing entitlements have been legislated away from beneficiaries. Enhanced benefit security should also make beneficiaries feel more confident about their DB pension plan.

The Panel recommends that:

Pension Security Funds

8.1.2-A Pension standards legislation should permit the establishment of a "pension security fund" (PSF) that would be separate from but complementary to the regular pension fund, on the following bases:

[56] As discussed under "Retroactive or prospective solution" above, by "ring-fencing," we mean isolating the assets and frozen liabilities of the old plan, without removing the trust conditions from them. No new benefits would accrue under the old plan; future accruals would come under the new wrap-around plan. Each would recognize the other plan's service and benefits for eligibility and vesting.

- **Contributions required to meet going-concern funding obligations should be forwarded to the regular pension fund as under current practice.**
- **Contributions required to meet solvency obligations over and above the going-concern obligations could be forwarded to the PSF.**
- **The PSF should be:**
  - **tax sheltered, held separate from the sponsor's assets and protected from creditors;**
  - **accessible to the plan sponsor with regulator consent:**
    - **as long as the sum of the regular pension fund plus the PSF (after access by the sponsor) exceeds the funds required to meet solvency requirements, with a five percent cushion, and the withdrawal is spread over a five-year period (20 percent of the excess per year)**
    - **based on a current valuation within one year of the most recent valuation date**
    - **but only if an actuarial certification that there has not been a material change since the valuation date is provided**
  - **returned to the plan sponsor on plan windup, to the extent not needed to meet benefit obligations and windup expenses.**
- **The PSF could also hold voluntary sponsor contributions greater than those required to meet solvency obligations, to assist in managing contribution volatility.**
- **The PSF could be structured as a trust, insurance contract or other financial funding medium acceptable under the federal *Income Tax Act*. (See Section 10.1 "Income tax rules" below.)**
- **The governments should consult with the CIA regarding detailed rules on PSFs (including certification requirements and frequency of valuations).**

Contribution holidays/surplus withdrawals – regular fund

8.1.2-B Contribution holidays in relation to, and surplus withdrawals from the regular pension fund would be permitted, on the following bases:

- **Contribution holidays should be permitted unless explicitly prohibited in the plan terms.**
- **Surplus withdrawal from the regular fund should continue to be permitted subject to regulator consent and only if the plan permits it or the members consent.**

- **Contribution holidays and surplus withdrawals should be restricted to ensure that they do not reduce surplus assets to less than five percent of the value of the liabilities as of the most recent review date.**
- **The financial position of the plan should be required to be updated (based on changes in interest rates and actual investment returns) before the withdrawal can be made or the contribution holiday can commence.**
- **Both contribution holidays and surplus withdrawals should be required to be spread over five years (20 percent of the excess per year).**
- **For the holiday or the withdrawal to continue after the first year, the financial position of the plan, the calculation of the five percent buffer and the amount of the surplus available should be required to be updated annually in a similar manner.**
- **Where a PSF had been established, a contribution holiday should be permitted in the regular pension fund:**
    - **to the extent that funds are in excess of going-concern requirements; and**
    - **as long as the sum of the regular pension fund plus the PSF (after the contribution holiday) exceeds the funds needed under the solvency valuation based on a 105 percent threshold.**

See Section 10.1 for recommendations relating to income tax limits on surplus assets.

Letters of credit

8.1.2-C Letters of credit should continue to be permitted for use in securing solvency deficiency obligations.

Legacy surplus issues

8.1.2-D Plans with "legacy" surplus issues should be permitted to "ring-fence" such issues by allowing the older plans to be frozen and new plans to be established with clear contractual provisions relating to surplus issues to "wrap around" the frozen plan, on the following bases:

- **The terms and conditions of the new plan with respect to surplus use and withdrawal should be subject to contract law.**
- **The existing plans, whose surplus use and withdrawal rules were governed by trust law, should be permitted to be closed to new entrants and frozen with respect to accruals of further service and recognition of salary increases.**

- **Recognition of vesting and other entitlements in the old plan should be required for the purpose of establishing benefit entitlements in the new plan, and vice versa.**
- **Benefits in the new plan should include recognition of salary increases with respect to service accrued in the frozen plan.**
- **There should be no requirement to wind up the "legacy" plan, but rather it would continue and form part of the members' ultimate benefits from the two combined plans, continuing to pay out benefits until all liabilities are discharged.**

8.1.3 Utilization of plan assets

The foregoing discussion has set out the Panel's general approach to funding rules and ownership and use of surplus. In this section we will consider in more detail the issues that arise regarding rights to use plan assets in particular circumstances, primarily in DB plans, including:

- plan mergers and divisions
- partial terminations
- contribution holidays in DB-DC hybrid plans
- payment of plan expenses
- reopening "closed" plans

The common theme in all of these issues is who owns and has the right to use the assets at the particular point in time, especially surplus assets, but also in some cases who is responsible for shortfalls. These questions are extraordinarily complicated and have been the subject of numerous court decisions over the last two decades. The decisions have not yielded a consistent legal direction because of the wide variety of situations and statutory provisions being applied. Sometimes there are no statutory provisions to guide the judiciary.

In more than one ruling, courts have explicitly recommended that legislators create a statutory solution to these issues. Courts have observed that if there is a statutory provision, the courts will apply it.

CAPSA's model law principles contain no mention of partial plan terminations. CAPSA considers partial plan terminations to be unnecessary given its recommended principle of instant vesting of employer contributions. The main justification for declaring a partial plan termination in the event of bulk terminations of members is that the pension standards require all members to be vested in the event of a plan termination, and rights on partial terminations under pension standards are the same as in a full termination. (Surplus entitlements are specifically excluded from rights on partial termination in Alberta and British Columbia's current standards.)[57]

Panel Perspectives and Recommendations

In our foregoing sections on DB funding rules and ownership of surplus we applied several general principles that we believe apply equally in these special circumstances. They are:

- Established property rights to surplus that is in a plan at termination should not be tampered with.
- At all times if a pension plan sponsor and members want to define their "deal" regarding surplus ownership and utilization in some other fashion they should not be precluded from doing so.
- Surplus in an ongoing plan should be available to the plan sponsor for contribution holidays unless the plan explicitly prohibits it. (See also Recommendation 8.1.2-B.) This is also consistent with evolving case law.
- Withdrawal of surplus by the plan sponsor should take place only if the plan permits it or the employees agree, and the withdrawal should be subject to regulator approval.

The Panel believes that, in developing standards in this area, the governments should rely on these principles. However, the Panel is also of the view that it is necessary and appropriate for the governments to set clear rules governing these situations, so as to provide certainty to plan sponsors and members. The Panel is concerned that the lack of certainty in existing case law around many of these issues results in DB plans being fully or partially terminated, particularly in the context of corporate transactions.

Since the Panel is not recommending the adoption of instant vesting, it follows that there would still be a requirement to declare a partial termination in order to trigger vesting rights in such circumstances. The existing criteria for events that constitute partial terminations in the two provinces' legislation appear reasonable. Nonetheless, we believe that partial termination filings should be made less onerous for administrators.

The Panel recommends that:

General rules

8.1.3-A The governments should adopt the following principles in the legislation for asset utilization:

- **Established property rights to surplus that is in a plan at termination should not be tampered with.**

[57] EPPA s. 1(1)(e) and s. 75; PBSA s. 53

- **At all times if a pension plan sponsor and members want to define their "deal" regarding surplus ownership and utilization in some other fashion, they should not be precluded from doing so.**
- **Surplus in an ongoing plan should be available to the plan sponsor for contribution holidays unless the plan explicitly prohibits it.**
- **Withdrawal of surplus by the plan sponsor should take place only if the plan permits it or the employees agree; the withdrawal should be subject to regulator approval.**
- **Surplus in new "wrap-around" plans and in PSFs should be dealt with as described in the Recommendations under Section 8.1.2 above.**

The governments should build upon these principles as the body of common law evolves with subsequent court decisions.

Partial plan terminations

8.1.3-B The following rules should apply with respect to surplus use and distribution on partial plan terminations:

- **Vesting of benefits should be automatic for all members affected by a partial termination but vesting should not include a right to surplus assets unless the plan specifically provides for it.**
- **Partial terminations should continue to be required, subject to the criteria in the current legislation (termination of an identifiable group, etc.).**
- **Administrators should be required to notify the regulator of a plan termination rather than being required to file a special report; the actuary of a DB plan should also report the event on a subsequent regular valuation.**

Plan mergers and divisions

8.1.3-C The following rules should apply to plan mergers and divisions:

- **A plan should be permitted, but not required, to transfer a proportion of the surplus equal to the ratio of the liabilities for the transferred members to the total of the plan's liabilities.**
- **The money transferred into the transferee plan should be allowed to be used according to the terms of the new plan.**

Plan expenses

8.1.3-D Plan expenses should be payable from the plan fund unless the plan text specifically provides otherwise. This default rule would supplement the current standard requiring all plan texts to contain a provision indicating how plan expenses will be paid.

It would address problems in old plans with unclear or nonexistent wording.

Re-opening closed plans

8.1.3-E Employers should have the ability to reopen a plan previously closed to new members unless the document of the closed plan was explicit that it could not be reopened.

DB/DC contribution holidays

8.1.3-F Where a plan has been converted from DB to DC leaving a legacy DB provision in place within the plan, surplus arising with respect to the DB provision should be available for employer contribution holidays in the DC portion of the plan as long as the DB and DC segments are part of the same trust (to the extent that the plan assets are subject to a trust). (See also Recommendation 8.1.2-B regarding the use of surplus for contribution holidays.)

8.2 SCTB funding and related rules

As indicated earlier, the Panel decided very early on that it had to address the issue of DB funding rules differently for different types of plans. In particular, we wanted to consider whether different rules were warranted for one particular type of plan that comprises a substantial portion of the membership of private sector plans in Alberta and British Columbia.

These plans commonly have the following characteristics:

- They are sponsored by unions, usually in the trades.
- They are governed by a board of trustees usually comprising employer and union nominees.
- In most of these plans, multiple employers participate, but the withdrawal of an employer does not result in the partial termination of the plan with respect to that employer's employees (however, some such plans can be for the employees of one employer).
- Employer contributions are fixed by collective bargaining agreement.
- Employers' liability is limited to their contractually required contributions.
- Benefits may be reduced if contributions do not support benefit levels.
- They are treated as DC plans under income tax rules.

For the most part, these plans have been subject to the same funding standards in Alberta and British Columbia as traditional employer-sponsored DB pension plans except that they can, with the superintendent's permission, reduce benefits if they are not able to demonstrate that they can fund a given level of benefit promise within those funding rules.[58] Unlike traditional DB plans, employers are not required to make up solvency deficiencies if a plan terminates.[59] Their liability is limited to the contributions that they have agreed to pay, usually as part of a collective bargaining agreement.

Unlike in many public sector plans, employees are not liable to pay higher contributions if shortfalls develop either – in fact, most of these plans require no employee contributions. Therefore, the only recourse, if a funding shortfall develops and higher employer contributions are not forthcoming either through collective bargaining or a reallocation of the bargained compensation package among various pay and benefit components, is to reduce benefits.

Obviously, the "pension deal" in these plans has unique characteristics. To identify clearly the plans in this category, the Panel has chosen a new nomenclature: Specified Contribution Target Benefit (SCTB) plans, which term can apply to either a single or multi-employer plan provided that the plan bears the following characteristics:

- Employee and employer contributions are "specified" or fixed by negotiation or other means.
- Employer liability is limited to contractually required contributions.
- Benefit levels are "target" rather than "defined" or "guaranteed".

The following discussion will use this new term, and pertains only to funding rules for these plans. It does not apply to single or multi-employer DB plans sponsored by groups of employers who bear the liability for funding shortfalls; neither does it apply to risk-shared DB plans, where employees and employers share the liability for shortfalls in the form of increased contributions, and where benefit reductions are not generally contemplated.

We have abandoned the term "multi-employer plans" when describing the plans to which these funding rules would apply because the recommendations apply based on the essentials of the "pension deal", notably who bears the risk and what are the consequences of unfavourable events, and not on whether one or more employers are involved.

Issues

Members, trustees and advisors to SCTB plans, in particular those speaking for the large majority comprising existing multi-employer plans, object to the application of solvency funding rules to their plans.

[58] EPPR, Schedule 0.2, s. 7; PBSR s. 35.
[59] EPPA s. 73; PBSA s. 51.

Those who oppose solvency funding for SCTB plans argue that the concept of solvency is irrelevant to these plans because they are unlikely to terminate. They make this claim because the plans are often established by a collective agreement and are not subject to unilateral cancellation by the employer, and because, in the case of a multi-employer plan, an employer's withdrawal does not trigger a partial or full termination.

Beyond being irrelevant, they argue, solvency funding is harmful to the interests of current and retired plan members because the conservative funding provisions required in order to avoid benefit losses on a plan termination unduly restrict the ability of the plan to provide benefits on a going-concern basis.

Nonetheless, these plans have other risks. For some SCTB plans where all members are employed by one employer, or where there is one very large employer whose workforce comprises a large percentage of the membership, employer withdrawal or business failure is a risk. But the risk factor common to all such plans is the fixed nature of the contributions. Neither the contribution rates nor the volume of contributions is under the trustees' control. At the same time, the terms of these plans set out a formula benefit to which members expect to be entitled based on the number of hours they have worked. The challenge for trustees is to meet expectations for benefits within the limitations of their control and without unduly rewarding or penalizing different generations of plan members.

Intergenerational equity and funding stability are the great challenges of SCTB trustees. But the question is, to what extent are these matters that trustees should be allowed to determine, exercising their fiduciary powers and responsibilities, and to what extent should regulators insist they adhere to certain standards? Should those standards restrict trustees' latitude in decision making, require disclosure to members and regulators, or both?

Consequently, the first issue in creating minimum funding rules for these plans is how to measure the likelihood that the promised benefits – even if they can best be described as "target" rather than "defined" benefits – can be delivered. The second issue is what remedial steps will be prescribed for those plans that cannot demonstrate funding adequacy. The third issue is what members need to know about the funding status, risks and potential outcomes of their pension plan.

Within the last two years, both Alberta and British Columbia have introduced temporary measures to deal with the special funding challenges of the multi-employer versions of these plans, pending the results of our deliberations. The temporary measures suspend solvency funding requirements for plans with solvency deficiencies for three years, provided the plans refrain from benefit increases and can demonstrate that their contributions are adequate to amortize existing unfunded liabilities over the lesser of 10 years or the remaining amortization period of previously established unfunded liabilities.

The expiration of these temporary measures.[60] reinforce the need to develop funding rules for these plans as distinct from other types of pension plans.

Our recommendations, therefore, will address the following questions:

- What minimum funding rules should apply to SCTB plans?
- Should they be required to
  - test and report to the regulator, and/or
  - fund

  on a solvency or a going-concern basis or both?
- What amortization periods should apply to shortfalls?
- Should they be required to perform and report to the regulator tests to estimate the impact of unfavourable events that would affect the plan's ability to deliver on benefits; if so, what events and what tests?
- Should they be required to demonstrate that the plan has a funding "cushion" to enable it to withstand unfavourable events and if so, how would the levels be set?
- What other rules relating to disclosure to members, benefit improvements, valuation frequencies, benefits to terminating members, and governance would complement the funding rules?

Discussion

Stakeholder views

Clearly the sponsors (both union and management) of SCTBs are overwhelmingly opposed to their plans being subject to solvency funding requirements, although there is fairly strong support for reporting the plan's solvency position to plan members and the regulator.

The calls for relief from solvency requirements have increased along with the growing size and frequency of solvency deficiencies. Solvency liabilities have increased with maturation of the plan membership and a decline in the interest rates used to calculate the liabilities. Erratic investment returns have meant that assets have not always kept up with these increases.

Those that oppose the application of solvency funding rules to SCTBs believe that the rules result in intergenerational inequity: present members receive lower benefit accruals and present retirees receive lower pensions for the sake of ensuring that in the unlikely

[60] British Columbia: deadline for application for relief is December 31, 2010; Alberta: "sunset" of regulation is December 31, 2009).

event of a plan wind-up, there would be sufficient assets to provide full benefits to everyone.

There is considerable support for the concept that these plans, which promise only “target” benefits, should be allowed to provide a higher “contingent benefit”, with a low probability that a lower benefit would be paid in the unlikely event of wind-up, combined with adequate disclosure to members of the contingent nature of the benefit. Those who support this concept argue that members are better served by receiving the contingent promise of a higher benefit on an ongoing basis than by being promised a lower benefit to insure against the low-probability event.

Those involved in union “negotiated cost” plans also argue that the solvency funding requirements are too volatile in their environment, in which contributions must be collectively bargained and therefore cannot be changed quickly and easily. They say contribution rate stability is the most important funding consideration for these plans because contributions are negotiated and can be changed only through collective bargaining.

Some other common statements to the Panel from the SCTB community, or at least the multi-employer majority of these plans, can be summarized as follows:

- Solvency liability calculations yield inappropriately high values because they are based on maximum-cost utilization of subsidized early retirement, whereas in practice this almost never happens in a going-concern plan.
- Since the employers’ liability is restricted to their collectively bargained contributions, a plan wind-up would not result in members receiving any benefits beyond what the plan’s assets on termination can support.
- Requirements to fund going-concern unfunded liabilities should be the same as for traditional single-employer plans (i.e. do not reduce the amortization period in lieu of solvency funding).
- All plans should have a funding policy.
- Minimum funding requirements should properly reflect the risk characteristics of these plans, and could encompass some measure of asset/liability mismatch. However, funding requirements should not take into account an employer’s health in cases where continuation of the plan does not depend on a single employer.
- These are “target benefit” plans and should continue to be allowed to reduce benefits if necessary to match funding, since employers’ liability is limited to the negotiated contributions. This limited liability is a desirable feature for attracting new employers and employees.

Notwithstanding the considerable support in the sector for the views outlined above, opinion is not unanimous. A submission endorsed by several union pension plan sponsors advocated replacing the existing solvency and going-concern funding rules with stricter going-concern funding rules, with a transition period to bring plans into compliance, with those that are unable to comply after the transition period facing future and accrued benefit reductions. Some of the features of the stricter rules suggested were:

- a conservative going-concern funding rate with margins for investment costs and contingencies
- market value of assets
- using a conservative costing method and in particular, a method that would show how many new entrants would be needed to keep contributions stable
- stress testing (estimating the impact of unfavourable events), with corrective action required if stress testing reveals an unsustainable financial situation
- disclosure to plan members of the plan risk
- triennial valuations if funding standards are met, but more frequent valuations if standards are not met.

There has been a strong write-in campaign to the British Columbia government, of which the Panel has been made aware, by hundreds of plan members and some retired members supporting their union and plan leaders' position that these plans should not be subject to solvency funding standards. Their concerns are mainly that solvency funding is overly stringent and denies them benefits that the plans can afford. It is at least implied in some of these submissions that the members understand that there may be an intergenerational transfer from active members to retirees if a plan has to wind up, but they are comfortable with the idea as they believe that is unlikely to happen. Some younger plan members express concerns that continuing benefit reductions will mean that they will not "get their money's worth" from the plan, but they appear to view solvency funding as the problem and not the solution to this intergenerational equity issue. The Panel has some concerns that neither the target nature of the benefit nor the implications of intergenerational transfers are well understood by plan members.

Most pensioner groups do not distinguish between these and other types of plans but their opinion generally is that pension plans should be fully funded on a solvency basis at all times, and that pensions should be indexed. They are also typically in favour of better disclosure to retirees of the financial position of the plan. The traditional position of unions and of pensioner groups highlight that benefit security is important, particularly to pensioners. If an SCTB plan were allowed to fund based on today's going-concern funding rules, the possibility would exist of the opposite type of intergenerational inequity – that future pensioners would see benefit reductions because unsustainably high benefits were paid to those who went before them.

The nature of "target benefits"

It must be remembered that, while these plans may, in fact, be "target benefit plans", they attempt to provide defined benefits and certainly communicate the benefits as such to beneficiaries (usually in terms of a flat benefit of $X per Y hours worked). The argument that these plans do not terminate is generally true, at least if there are many employers contributing to the plan, but perhaps misses the point that a measurement is needed of the plan's estimated liability for "targeted" benefits. This is particularly important as these plans mature and a larger proportion of liabilities are for retirees and deferred vested members. These plans attempt to provide annuity-like benefits and therefore a properly determined settlement value for such benefits is relevant, and becomes more relevant the closer the liability is to maturity.

A weakness of the current regulation is that it is not flexible enough to recognize "target" or "contingent" benefits, nor does it allow for a temporary benefit promise. The trustees are allowed to reduce benefits only as a last resort – otherwise, they are compelled to provide benefits exactly as per the formula in the plan – and often a reduction in benefits will have been preceded by a reduction in future accruals.

Risks of SCTB plans

Like traditional DB pension plans, these plans are vulnerable to unfavourable investment results. Although it may be less likely, they can still be affected by business failures where the plan has a single employer or one employing a large portion of the members. They can also face risks if the union membership eligible to belong to the plan declines significantly because of changes in union organizing activities or because they are in a failing industry.

But the unique risks of these pension plans lie not in the potential for a company to fail or discontinue its pension plan but in the fact that contribution cash flows are the product of two elements, neither of which is under the control of the trustees: contribution rates, which are not easily adjustable, and contribution volumes, which are based on hours worked by the members. Any adjustment of the contribution rates depends on a process outside the pension plan, usually collective bargaining, which is influenced by many factors besides the pension plan's funding needs. Hours worked in a given industry can be either fairly stable or highly variable, again due to factors external to the pension plan.

A third important risk factor is the degree of maturity of the plan membership. As a member approaches and reaches retirement, the importance of having funds to deliver on the benefit promises becomes more pressing. There must not only be assets of sufficient value to back the promise, but the plan requires sufficient liquidity to generate the cash flow for benefit payments. Trustees generally do everything in their power to avoid benefit cuts to retirees. If the plan's membership is heavily weighted toward long-service and retired members, this can become a huge issue.

Consequently, any measurement of SCTB funding risk must consider the sources of vulnerability and estimate their impact. "Stress testing" could estimate the impact on the plan of significantly adverse experience on key variables: contributory hours and investment returns on equities. Where the plan would be vulnerable to the failure or withdrawal of a particular employer, that particular scenario could be tested. Where the plan has only one employer, this would amount to a wind-up scenario. The objective would be to determine whether the plan's status would deteriorate below acceptable levels within a given time horizon if any of these untoward events should occur. If unacceptable deterioration were to occur, the funding rules would set standards for time limits on remedial action. Among the potential remedial actions would be reductions in benefits.

Stress testing can take the form of deterministic or stochastic testing or both. Stochastic tests involve generating a large number of scenarios by changing variables such as annual investment returns, longevity and hours worked using a random process that simulates the uncertain real world. The test produces a range of possible outcomes and probabilities of good versus poor outcomes. Deterministic tests construct specified scenarios; for example, a 25 percent unfavourable change to hours worked from one year to the next, and the test result is a single outcome.

An important aspect of stress testing is the plan's degree of "mismatch risk". "Mismatch" refers to a difference between the duration of the assets and the liabilities. A conservative funding strategy would be to hold a greater proportion of high-quality bonds and other reliable fixed income assets as the proportion of retirees and near-retirees increases, to ensure that cash flows from investments arrive on schedule to help the plan deliver on benefit promises. But these types of investments are expected, based on experience, to yield lower returns over the long term, thus lowering the contribution that investment earnings make to assets available for benefits and raising the amount that must be contributed by employers and/or employees. Therefore, pension fund fiduciaries typically elect to weight their portfolios more heavily in riskier assets such as stocks with greater potential returns. This is usually thought to be justifiable given the long-to-indefinite time horizon of a pension plan, especially one with a low probability of terminating. However, it becomes less justifiable if the plan membership ages on average, and consists of a large percentage of older workers and retirees.

Actuarial science is increasingly turning its attention to the dynamics of mismatch risk and other risks faced by pension plans. Many actuaries are now advocating that plans build up contingency reserves or PfADs representing a percentage of liabilities on a sliding scale depending on the nature and degree of the risks and the probability of unfavourable events. While there are proposals being considered, there are as yet no official actuarial standards surrounding PfADs.

Benefit considerations

Another aspect of trustees' responsibilities is to approve benefit increases when warranted. This can be a source of considerable pressure especially if there has been a long period of benefit freezes or even reductions. But it is equally important for benefit improvements to be made in a controlled and measured fashion as it is to take timely and deliberate steps to deal with shortfalls. In this area as well, the regulatory system has not so far imposed standards designed to address the special characteristics of these plans.

Ideally, of course, the plan's trustees would be able to keep funding on an even keel and benefits would be delivered as expected in all cases. Nonetheless, the plans are target benefit plans, and as such, members' benefits may ultimately not be delivered at the levels expected. Therefore, the members need to be kept informed about their plans' financial status and any risks to their benefit levels.

A side issue raised by a few plan administrators and advisors is what level of benefits are owed to an individual terminating from the plan, especially if the plan is being funded on a going-concern basis only, without reference to solvency. At present, the Acts require that plans provide terminating vested members with the full commuted value of their entitlement, which includes maximum recognition of the value of any special early retirement benefits and is intended to approximate the cost for the member to purchase an annuity delivering the same benefit.[61] The present standards also prohibit a full transfer of that value if the plan is under-funded on a solvency basis. The initial transfer must comprise a portion of the individual's entitlement based on the current solvency ratio, but within five years when, presumably, the solvency deficiency has been amortized, the plan must pay the individual his remaining entitlement.[62] Clearly, if solvency funding were to be discontinued, and if the benefits are, at any rate, to be considered "targets" rather than outright promises, this method of determining and paying transfer values must be reconsidered.

The regulatory challenge

While taking these more complex factors into account in funding rules would enable more accurate monitoring and more flexible solutions for plans encountering problems, it increases the regulatory challenge. The pension regulator would have to have full, current information about the risk status of the pension plan, and discretion and flexibility to require or approve a variety of solutions based on much more complex criteria than now exist in the regulation. As a result the quality and quantity of regulatory oversight and the skills required to do it properly would increase.

It should be noted that solvency testing, as currently required, not only signals the need for remedial action and limits transfers out that would further damage the plan's funded status, but also provides an important measure of the financial health of the plan: a proxy for its settlement status. It assumes the promised benefits would have to be settled, and measures the current market value of the assets that would have to be liquidated to effect the settlement. Even if the benefits are "targets", this provides useful information about the extent to which the plan is capable of achieving those targets. This information is of value to the plan fiduciary, the regulator, the members and any other beneficiaries.

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[61] PBSA s. 33; EPPA s. 38

[62] PBSA s. 33 and s. 60; EPPA s. 38 and s. 82(3)

Panel Perspectives and Recommendations

The Panel is of the view that the nature of the "pension deal" in SCTB plans makes it desirable to devise a different set of minimum funding standards than for traditional employer-sponsored DB plans.

Because employers do not bear the burden of funding shortfalls, it falls on the members, either in the form of higher pension contributions which limit increases in their other wages and benefits, or in the form of reduced pensions. The objective of funding rules should be to foster a system where plans can achieve optimum stability of contributions and benefits without unduly rewarding or penalizing any subgroup of plan members.

The Panel accepts the argument that SCTB plans are less likely to terminate than traditional single-employer DB plans, but believes that protections must be in place for the potential of termination where the plan comprises few (or one) employers, or is for workers in a faltering industry. As well, there must be appropriate recognition of the impact of the withdrawal of a major employer or a significant decline in plan membership.

We recognize that stability in both contributions and benefits is highly desirable. However, a high degree of stability in benefits can be achieved in these plans only if the fiduciaries take a very conservative approach to setting benefit levels and to their selection of assets. Some pension plan fiduciaries may adopt this approach if it seems appropriate to them given their plan's circumstances and the preferences of their membership. But for many others, viewing the benefits as "targets" and clearly communicating them as such to members, along with an explanation of the circumstances in which the targets may not be reached, provides a needed "safety valve" for the fiduciaries.

Enhanced going-concern, or "going-concern-plus" funding rules would allow for a less variable pattern of contributions and benefits than would occur under solvency funding rules. Such rules would be designed to enforce a discipline on the governing fiduciaries, resulting in a high probability that the targets will be met, and they minimize the likelihood of benefit shocks if unfavourable events occur. The "plus" portion would be a requirement to demonstrate that the plan has PfADs, a cushion of assets exceeding the going-concern liabilities, the size of which would be based on specific conditions of the plan.

Another aspect of enhanced scrutiny aimed at the specific vulnerabilities of these plans is stress testing. There is value in requiring specific minimum deterministic tests to be performed for all SCTBs because it applies a single standard across plans and across time, making it clearer and easier to understand for the regulator, the governing fiduciaries and plan members. Stochastic testing provides added information for the trustees and the regulator, not only about the impact of a given set of unfavourable circumstances, but about the probability of their occurring.

At the same time, we believe the standards should foster a conservative approach to benefits, especially benefit increases, for the same reason as was outlined above for adopting going-concern-plus funding rules – it enforces a discipline on governing fiduciaries and minimizes the likelihood of shocks.

As part of this conservatism, and in keeping with the target nature of the benefits, we have specific recommendations about amounts that can be transferred from the plan by a terminating member. A member leaving a plan should be in no better or worse position at that point in time than members remaining in the plan. If these plans are "target benefit" plans there is no justification for delivering a full benefit to departing members when there is a funding shortfall, as remaining members may eventually receive benefits lower than the target. If the terminating members want to enjoy the protection of a going-concern funded ratio that may be 100 percent or greater at some point in the future, they can exercise their option to leave their benefits in the plan.

We regard disclosure to members as a vital element of establishing a new funding regime for these plans because it makes the nature of the "deal" absolutely clear to beneficiaries who, after all, do not individually and directly agree to the deal. The Panel would not support abandoning solvency testing and funding in favour of strictly going-concern standards unless strong disclosure rules are adopted in conjunction with the funding rules.

The Panel hopes its recommendations will end arguments about the relevance of the concepts of "solvency" or "wind-up" valuations. The issue is not whether a plan will wind up but whether it can deliver the benefits it is targeting. Those benefits must be properly valued, the risks to the particular plan must be recognized and the impact of unfavourable events on key factors must be tested: namely, contributory hours, investment returns, and the demographics of the plan membership.

Consequently, we do not regard the following recommendations as offering "solvency relief" as some have requested, but rather a new funding regime. It will require testing the impact of various risks that the plan faces, and requiring remedial action that moves the plan toward a balance between its "target" and its ability to achieve it.

Finally, we believe it is important to ensure that governance practices be aligned with the special nature of the "pension deal" in these plans and the especially difficult responsibility trustees of these plans have to balance the interests of all plan members and make prudent, even-handed choices in the face of many uncertainties in their environment.

The Panel recommends that:

Funding rules for SCTBs

8.2.1-A A new category should be created in the pension legislation for funding and disclosure for single and multi-employer plans with similar characteristics, called specified contribution target benefit plans. The essential characteristics of such a plan are:

- **Contributions are limited to specified employer and employee contributions ("specified" by the parties to the deal, whether through a collective bargaining agreement or another method).**
- **Employer(s) are limited in their liability to providing the specified contributions.**
- **There is a formula benefit set out in the plan document but it is subject to reduction if funding is not sufficient and can therefore be considered a target benefit.**

8.2.1-B There should be a single funding test for the purpose of setting minimum funding standards. It should be a "going-concern plus" test:

- **Going-concern liabilities should be estimated using "best estimates" of long-term going-concern assumptions, following generally accepted actuarial practice.**
- **The actuary should have to demonstrate that the plan has an appropriate PfAD. The variables at issue could include, but not necessarily be limited to:**
  - **distribution of liabilities between active and deferred / retired members,**
  - **degree of mismatch between assets and liabilities, and**
  - **variability of hours worked**

  The greater the volatility of the above variables, the greater the PfAD needed. The result would be a target going-concern funded ratio of 100 percent at minimum, rising with the degree of PfAD.
- **The funding rules should either specify the magnitude of the PfAD or incorporate actuarial standards addressing the same issue. As actuarial standards are yet to be developed in this area, the CIA should be asked to develop such standards or at least to advise legislators on appropriate PfAD standards.**

8.2.1-C To determine the size of the PfAD and the prescription for remediating problems, the funding rules should require that stress testing be performed as part of the actuarial valuation:

- **The standards should require the actuary to perform all appropriate scenario tests which must include both stochastic tests, and specified deterministic scenarios.**
- **Standards for stochastic testing should have to state what level of statistical confidence would be required.**
- **Where the plan would be vulnerable to the failure or withdrawal of one or more employers, that scenario should be included in the stress testing. Proportionate and appropriate protection should be factored in when there is an apparent significant chance of wind-up.**

- **It is important that the actuarial profession be engaged to develop stress testing metrics. Actuarial standards do not currently exist in this area; therefore, the CIA should be asked to create such standards. If the profession declines to create such standards, the legislation should impose them based on advice from actuarial consultants.**

8.2.1-D **If going-concern liabilities plus any necessary PfAD are greater than assets, deficiencies should be required to be eliminated by increasing contributions and/or reducing benefits so as to restore the plan to the target funded ratio. The remediation should be required to be achieved with regular, consistent and timely treatment:**

- **The plan should have to demonstrate that contributions would be sufficient to amortize unfunded liabilities over 15 years or the "expected average remaining service life", whichever is less. The other rules relating to unfunded liabilities would continue to apply:**
  - **Once identified, an unfunded liability should be required to be amortized in that length of time or less and should not be allowed to be combined with more recently established unfunded liabilities so as to extend the amortization period beyond the original maximum period.**
  - **Gains should be required to be applied to the oldest-established unfunded liability first, with the result that either the payments would be lowered or eliminated, or the same payments would continue but the unfunded liability would be amortized more quickly.**
- **If funding levels indicated above are not met, the plan's funding status should be required to be adjusted immediately by contribution increases, changes in plan design (e.g. benefit reductions or increased eligibility requirements) or a combination of those. The trustees should have the primary responsibility to exercise even-handedness in making any changes in plan design.**

Benefit improvements for SCTBs

8.2.2-A **The legislation should also require that a reasonable method be used for costing benefit improvements: benefit improvements should be valued on the same going-concern-plus basis as required for the minimum funding standards.**

8.2.2-B **No benefit improvement should be permitted unless there is at least a 100 percent going-concern-plus funded ratio and no benefit improvement should be allowed that would reduce the plan's funded status below the fund's target ratio.**

8.2.2-C **To provide more flexibility in plan design, temporary benefit improvements should be permitted, subject to the general**

limitation that there must be a going-concern-plus surplus. These improvements must be accompanied by full disclosure to plan members of the temporary nature of the benefit and who is entitled to receive it. Such improvements should be subject to Recommendation 8.2.2-B limiting benefit improvements.

Valuations for SCTBs

8.2.3-A The current standards for frequency of valuations should be retained. The regulator should continue to have discretion to require more rigourous and/or more frequent valuations and/or additional stress testing as part of risk-based monitoring.

8.2.3-B In any SCTB plan where the probability of wind-up is higher, the actuary should be required to take into account the wind-up scenario in setting the going-concern-plus assumptions. The more probable the windup scenario the closer the going-concern-plus valuation should be to a wind-up valuation.

8.2.3-C The valuation filed with the regulator should state the target funded ratio and how it was calculated, including making the PfAD explicit.

8.2.3-D The valuation should be required to include an estimate of the amount that would be required to settle all liabilities at that point in time (settlement valuation), and state the settlement ratio.

Allocation of assets on wind-up of an SCTB

8.2.4-A In the event of a wind-up, every beneficiary (active, deferred or retired) should receive a portion of the total wind-up assets as determined by the trustees. The Panel makes no recommendation about how to calculate the wind-up liability for each beneficiary, and does not recommend any change in the hierarchy of priority currently in the legislation for discharging liabilities in accordance with the degree to which benefits are funded. The trustees should have the primary responsibility to exercise even-handedness.

Transfer values

8.2.5-A An individual's termination benefit should be valued using the same assumptions as were used in the most recent valuation, that is, on a going-concern-plus basis.

8.2.5-B The maximum termination benefit any individual may receive should be 100 percent of the going-concern liability. Even if the current funded ratio is over 100 percent to meet the plan's target funded ratio, the maximum payment should be 100 percent. If the ratio is less than 100 percent, terminating members who elect to remove their funds should receive a pro-

rated amount, based on the funded ratio at that time. There should be no later "catch-up" payment to bring their payment to 100 percent of the target benefit.

SCTB governance

8.2.6-A Our recommendations relating to governance standards in Section 7.1, and trustee/fiduciary education in Section 7.1.1, should be adopted to complement these funding rules. We do not endorse any single governance structure as the most suitable.

8.2.6-B As indicated in Recommendation 7.1-C, a funding policy should be a mandatory element of the governance policy for these plans. Some of the special requirements related to funding policies for SCTBs should include:

- **There should be a policy on benefit increases.**
- **The legislation should require that the actuary, in the actuarial report, opine that there is nothing in the funding policy that is inconsistent with sound actuarial practice for the particular plan.**

8.2.6-C The governing fiduciary should be required to certify that the plan has been managed in accordance with its governance policy, funding policy and investment policy.

8.2.6-D There should be a requirement for an annual assessment by the governing fiduciary of the plan's administration, its compliance with legislated minimum standards, governance, funding and investment policies, and the performance of the trustees, administrative staff and significant external professionals. The assessment should be in writing and available to the regulator upon request, but should not be required to be filed.

8.2.6-E Governing fiduciaries should be required to obtain the education and training required in order to properly meet their responsibilities. (See also Recommendation 7.1.1-B.)

8.2.6-F Governing fiduciaries should be required to ensure that those with administrative responsibilities with respect to the plan are appropriately trained.

SCTB disclosure to members

8.2.7-A The SCTB's settlement ratio should be required to be disclosed annually to all persons with entitlements under the plan:

- **The disclosure must explain the contingent nature of the target benefit and the circumstances under which it would be necessary to reduce plan benefits.**

- **Disclosure of the settlement ratio should be accompanied by an explanation of what it means: that it is the percentage of the target benefit that members as a group would receive if the plan were to wind up or if they remove their funds from the plan voluntarily, and that each individual's benefit may be higher or lower than that percentage, depending on the trustees' determination of how benefits should be allocated.**

8.3 Temporary measures

Panel Perspectives and Recommendations

The Panel believes its recommendations for minimum funding rules would provide a solid foundation to promote benefit security in DB and SCTB pension plans for the long term. However, as this report was being written, an international financial crisis struck, with severe declines in financial markets, a resulting deterioration in the outlook for national economies worldwide, and unprecedented measures by many governments to deal with the crisis.

The impact on pension plans was immediate and severe because their funds are invested in financial markets. There have already been calls to ease funding requirements by delaying valuations that would otherwise result in re-setting funding requirements, or extensions of the maximum period for amortizing deficiencies.

This crisis demonstrates that governments must be flexible and responsive at such times. It does not, in our view, argue for permanent, across-the-board retreat from standards that have as their objective the security of members' benefits. Standards exist not only to impose corrective measures but to signal what measures plan sponsors need to take proactively to avoid being unable to respond to a crisis.

In both Alberta and British Columbia, the legislatures have given the Lieutenant Governor in Council (effectively, Cabinet) the power to exempt plans or those responsible for them from the normally applicable standards, and impose alternate standards temporarily or permanently. The Panel believes it is appropriate for the governments to respond to exceptional circumstances by using such powers to provide temporary exemptions from the normal funding standards. It is important to keep this flexibility in the next generation of legislation.

The Panel recommends that:

8.3-A The legislatures should continue to delegate to the Lieutenant Governors in Council the power to exempt plans or those responsible for them from the normally applicable standards, and impose alternate standards. Governments should continue to use

their power to provide temporary relief in exceptional circumstances broadly affecting all pension plans.

9.0 Specific Pension Standards

Throughout this report, the Panel has identified numerous areas where we believe that either a principles-based or rules-based approach is appropriate under next generation legislation.

However, there are many aspects of the current legislation that are likely to be maintained in some form in any new legislation. Many of these specific standards are currently not harmonized between Alberta's and British Columbia's legislation. Other standards may be harmonized, but may be considered to be "irritants" that serve little substantive purpose in the legislation or are poorly conceived and only increase the cost and complexity of legislative compliance.

In this section of the report, the Panel has undertaken an analysis of one particular standard, locking-in rules, about which much discussion and debate has taken place in recent years. This issue does not fit neatly into any other topic area of this report, but is considered by the Panel to be sufficiently important to warrant discussion around the topic.

The Panel has also undertaken a review of other specific standards raised by submitters or identified by the Panel as being "irritants" or otherwise being in need of harmonization. Unless dealt with in other portions of this report, these standards require consideration as to whether they should be retained, modified in some way or removed from next generation pension standards legislation.

9.1 Locking in

Issues

- With respect to funds in locked-in accounts, should former pension members who own such accounts be able to unconditionally unlock their pension funds? If so, should unlocking be permitted only after retirement age or at any age?
- In addition, if unlocking is to be permitted, what percentage of their fund should account owners be able to unlock: for example, 25, 50 or 100 percent?
- Should unlocking be allowed for reasons of financial hardship, shortened life expectancy and/or small amounts? If so, should these programs run in conjunction with one another?

Discussion

There are two "watersheds" related to the unlocking of pension funds: first, whether the funds are still in the plan or have been transferred due to termination, death, divorce or retirement and second, whether a person is pre- or post-retirement age. Currently, jurisdictions across Canada are quite varied on both of these fronts. For example, for small amounts unlocking, some jurisdictions allow unlocking from both pension plans and locked-in accounts, while others only allow unlocking from locked-in accounts; some allow small amounts unlocking at retirement age while others allow it at any age. Thus, the treatment of these criteria has varied immensely.

A number of stakeholders want harmonized unlocking legislation. Some stakeholders' desire for a standardized act trumped concerns about what, exactly, the legislation should contain – so long as it is the same in both jurisdictions they would be satisfied. However, for many other stakeholders, while harmonization was desirable, the particulars of the legislation were highly contentious, perhaps because of the large gap between the current standards in Alberta and British Columbia. Harmonization in this area would prevent "the-grass-is-greener-on-the-other-side" thinking among stakeholders who view the other jurisdiction as having the better system and would certainly ease administration for plan administrators and financial institutions in the two provinces. However, because of the disparity between the systems, choosing which regime to follow presents multiple public policy questions.

The unlocking policy spectrum ranges from not allowing unlocking for any reason, to allowing 100 percent unconditional unlocking. No jurisdiction in Canada currently has an exemption-less unlocking scheme, while only Saskatchewan offers 100 percent unconditional unlocking at 55 or older. The more traditional unlocking exemptions include shortened life and small amounts unlocking, while more recent developments include financial hardship, non-residency and unconditional unlocking of a portion of the account. Therefore, the policy spectrum includes the adoption of one of these provisions or several in combination with one another. However, the adoption of one option may render another option redundant—for example, it would not be necessary to offer small amount unlocking if there is 100 percent unlocking in other circumstances.

Stakeholders who advocate for locking-in often tout the benefits to the individual and society of a system requiring account owners to use their funds for retirement income, while those who advocate unlocking argue that the increased flexibility unlocking provides is desirable. Related to these arguments are underlying assumptions about how prudent members exiting their pension plan will be with their money. While those who advocate for locking-in assume owners will invest or spend their money imprudently, thus outliving their retirement funds, those in favour of unlocking assume retirees will invest or spend their money prudently and *not* experience financial shortfalls during retirement. As unconditional unlocking is a relatively new development, it is hard to know which assumption will prove more correct. Clearly, differences between individuals' financial situations and behaviour make a single generalization impossible. Such assumptions also raise issues of the individual versus the collective: plan members often view pension funds as deferred income which means they should have the power to spend the money as they see fit. At the same time, there is a collective concern that, given this freedom, pensioners could exhaust their savings, becoming solely reliant on government programs for retirement income, and therefore, burdening their fellow citizens. Some people argue that the preferential tax treatment for pension monies justifies locking-in on the basis that taxpayers as a whole are willing to forgo immediate taxes in the interests of reducing future dependency on taxpayer-supported pensions.

Compassionate unlocking

The two traditional unlocking exemptions (small amounts and shortened life expectancy) are currently options at the federal level and in nine provinces. However, some stakeholders feel that even these exceptions have the effect of undermining the guarantees that pension plans should provide, or that they are hard to administer. Thus, a determination that the pension system's sole purpose is to guarantee retirement income would likely imply these exemptions to be contrary to that goal.

Financial hardship unlocking currently exists in Alberta, Ontario and Nova Scotia and for federally administered pensions. Most submissions did not discuss financial hardship unlocking. Those who favour unconditional unlocking would also favour financial hardship unlocking, unless they think unlocking by inference should be restricted to those of a certain age. Predicting the opinion of those opposed to unlocking is more difficult, however. It is likely at least some of these submitters view such unlocking as undermining the pension system while others may view unlocking for such compassionate reasons as worthwhile.

Unconditional unlocking

For unconditional unlocking, the options used in Canada have been 25, 50 or 100 percent. Most submitters who proposed a specific target supported 50 percent unlocking, though it is unclear whether this support is based on public policy considerations or is simply because this is what is currently allowed in Alberta. The arguments for or against one of these amounts are similar to arguments whether or not to allow unlocking: those arguing for 100 percent see it as providing flexibility, those arguing for 25 percent see it as providing greater security.

The argument for 25 percent unconditional unlocking is that it would provide some flexibility, but still ensure the bulk of the funds would be used to provide a pension even if a pensioner spent the unlocked portion foolishly.

Unconditional unlocking of 50 percent stems from rules surrounding who contributes to the fund. It is based on the assumption, not always true, that roughly half the fund will be from contributions from the employer and half from the employee. Thus, unlocking 50 percent would allow owners to unlock "their" money while keeping the "employer's" money locked-in to provide retirement income. Unlocking half can also be seen as a compromise between those not wanting unlocking and those wanting complete unconditional unlocking.

Full unlocking is favoured by those who think it should be up to account owners how they spend their money and to reap the rewards or suffer the consequences of their decisions. Some would argue full unlocking could occur either at the termination of employment or at retirement age; others would advocate it only at retirement age. Full unlocking may have the added benefit of being easier to administer as other exemptions could be made redundant. If specific exemptions (which are hard to administer) were replaced this would also benefit financial institutions, who have a difficult time administering these exemptions, as they are being forced into a compliance and enforcement role. Some employers and unions think that 100 percent unlocking undermines the pension promise which, in extreme cases, could deter some employers from offering plans to their employees. They could be characterized as more paternalistic – comforted by the knowledge that their contributions and administrative costs are guaranteed to go towards retirement income. Others may not care once the account owner is no longer their employee.

A related issue to unconditional unlocking is the question of when former plan members can unlock. The first issue is whether there should be age restrictions. The second is whether it is a one-time choice. Most jurisdictions that allow unlocking offer only one-time unlocking, often in conjunction with a time frame. For example, Ontario (which allows 25 percent unlocking) requires the unlocking to occur within 60 days of transferring the money into a ”New LIF”. The general rationale for allowing once-in-a-lifetime unlocking is that it limits the amount a person can unlock and may reduce the chance a person could spend unwisely. It is also easier to administer than repeated withdrawals. However the opposite argument could also be made: people who are unsure about how much to unlock could unlock the full amount whether or not they have a pressing need because they know it is their only opportunity to do so.

An alternative to unlocking for retirees could be to increase the maximum allowable yearly withdrawal from a LIF. This approach would increase flexibility for retirees, especially for those who wish to spend more of their retirement fund during the earlier stages of their retirement. Pensioners who fall into this category may wish to spend more than the current maximum amount and may unlock their pension fund as a way of doing so. This method could provide more flexibility than not allowing unlocking, while preserving some guarantee that funds will not be spent too quickly. However, those favouring locking-in may still see this as undermining pension security while those favouring unlocking may still see this as needless paternalistic controls over their money. Alberta liberalized its LIF withdrawal terms in 2006. British Columbia has retained a comparatively strong locking-in requirement, but did relax its locking-in rules slightly in 2004 by eliminating the requirement to purchase a life annuity by the time the plan member reaches age 80, allowing LIF owners to access the value of investment returns that exceed the maximum withdrawal from their LIF and permitting plan members to unlock small locked-in Registered Retirement Savings Plan (RRSP) and LIF accounts (for 2008 this amount is $8,980). These changes supplemented an existing rule that allows funds to be unlocked due to shortened life expectancy.

Another alternative is to allow unlocking but to charge a penalty tax on early withdrawals similar to the rules in the United States. This could give people an opportunity to access their money if needed, but would provide an incentive to keeping it locked in. However, people would resent paying a penalty to access "their" money. Furthermore, it is questionable whether putting the money into tax revenues is a desirable result — "yes" if the purpose is to defray costs to social programs of supporting imprudent spenders, "no" if the impact on the individual's financial status is considered.

Another option is for no additional tax to be charged, and withdrawing money from a pension plan could become similar to withdrawing money from an RRSP. People would be discouraged from withdrawing early if the amount of tax they would pay on the withdrawal would be less when retired due to their income being lower. Many people *only* have RRSPs (which are not locked-in) and many with locked-in pensions resent the paternalistic controls placed on their funds while others can access their money as they wish. This double standard judges those with regular RRSPs to be capable of planning their own retirement but not those whose savings came from an RPP.

A further option is to remove all exemptions and have no unlocking for locked-in funds. Such a system would ensure pension funds are used for retirement income. Many pension plan sponsors would be in favour of this as they would know the time and money spent providing and administering the plans would not be for naught. Some individuals would also favour this system as it would safeguard against those who would spend recklessly and leave themselves dependent on government assistance. This system would also be easier to administer. However, many current plan members and owners of locked-in funds would be against such a move as it would take away any flexibility they have with regards to their spending.

If nothing else, these arguments and the submissions received by the Panel were largely indicative of the lack of uniformity and indeed the polarized perspectives surrounding this issue.

Panel Perspectives and Recommendations

The Panel recognizes that there is clearly no consensus on the issue of unlocking of pension funds in Canada. The many and varied approaches to the topic across the country demonstrate that reactions have been made at the political level, and that no generally accepted policy perspective exists beyond traditional areas of "compassionate" or "expedient" unlocking.

In the Panel's view, pension plans are intended to provide secure income in retirement and the tax-advantaged status of pension contributions and entitlements are designed with that in mind. The Panel does not support unlocking of pension entitlements in general. This view has also been supported by the British Columbia government's position on the issue to date. However, the Panel does acknowledge the many voices who have been heard by other governments, including Alberta's, as being in favour of unlocking, and that to undo the changes made in Alberta to permit 50 percent unlocking would be both difficult and viewed negatively by many plan members.

That being the case, and in light of the desire to harmonize standards between Alberta and British Columbia, the Panel supports a position that takes both competing views into account. The Panel generally supports the concept of 50 percent unlocking as striking a balance between the competing perspectives on this issue. However, the Panel believes that some flexibility to establish a lower level of unlocking should be permitted in the context of a particular "pension deal".

The Panel recommends that:

9.1-A Unlocking of funds subject to pension standards legislation in Alberta and British Columbia should only be permitted on the following bases:

- **Pension funds should remain locked in so long as the individual is still an active member of the plan.**
- **SCTBs should retain the ability to set rules regarding when an individual is or is not a terminated member.**
- **It should be optional whether a plan permits unlocking.**
- **If a plan permits unlocking, individuals who are at least age 50 should be permitted to unlock either 25 percent or 50 percent of their entitlements, on a one-time basis, at or after termination of employment. The unlocked amount could be transferred to a non-locked in RRSP, while the locked in portion could be transferred to a LIRA or locked-in RRSP.**
- **If the plan is silent on unlocking, then 50 percent unlocking at age 50 or over at the member's election should be the default.**
- **There should be no change to the existing rule that plans may disallow portability within 10 years before normal retirement.**
- **For transition purposes, individuals subject to the current Alberta legislation who are age 50 or over at the time the new legislation is enacted should be "grandfathered" under that rule regardless of the option selected for the plan going forward.**
- **There should be no change to the existing unlocking rules (subject to harmonization) with respect to:**
  - **shortened life expectancy;**
  - **non-residency in Canada; and**
  - **small amounts.**
- **Financial hardship unlocking should be applicable in both provinces using the Alberta model.**

9.2 Standards requiring harmonization and standards perceived as "irritants"

Issues

What specific standards in the existing Alberta and British Columbia legislation are currently not harmonized? How should harmonization of such standards be achieved?

Are there some pension standards that should be abandoned or changed significantly?

What specific pension standards could be classified as "irritants", and how should they be changed?

Discussion

As discussed in Section 6.5, many stakeholders favour harmonization in order to ease the administrative burden for plan sponsors of MJPPs. However, others are concerned that harmonization of the standards will result in a general dampening of the effectiveness of such standards.

In short, the Panel's stated perspective in Section 6.5 is that harmonization of Alberta's and British Columbia's pension standards would simplify regulatory requirements, reduce unnecessary administrative cost and burden, facilitate labour mobility and contribute to the competitiveness of the provincial economies. The goal of the harmonization process is to select the *most appropriate standards* for achieving the stated objectives of the legislation. The development of appropriate standards may involve selecting either Alberta's or British Columbia's approach, developing a new or improved provision, or eliminating unnecessary requirements, thereby addressing concerns about harmonization resulting in a "race to the bottom".

The process undertaken by the Panel in preparing this section of the report was not intended as a comprehensive, side-by-side review of each and every provision of the statutes in the two provinces. Rather, the Panel has addressed only those standards identified by submitters or by the Panel as being sufficiently important to warrant review.

Panel Perspectives and Recommendations

The Panel's review of the provisions referred to above indicates that many of those provisions require both harmonization and modernization. Other provisions serve no meaningful purpose and should be eliminated from next generation pension standards legislation.

The Panel recommends that:

9.2-A The specific pension standards identified in Appendix C to this report should be revised and harmonized on the basis indicated in Appendix C.

9.2-B In ultimately developing harmonized next-generation pension standards legislation, the two governments should conduct a full review of all provisions of the existing statutes in both provinces to determine which additional provisions require alteration, elimination or harmonization, consistent with the objectives and principles of that new legislation.

10.0 Related Legal and Other Frameworks

The topics canvassed in this section of the report are designed to address issues raised by submitters in response to the following questions from the Panel's Discussion Paper:

- To what extent are other legal issues within provincial jurisdiction creating problems in the pension system, and how could these problems be corrected?
- 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?
- Are there areas in which federal and provincial rules are working at cross-purposes, and how could these conflicts be corrected?

10.1 Income tax rules

Issues

Any changes made under provincial pension standards legislation affecting the funding and benefits of registered pension plans must be made in cognizance of the parallel tax regulatory regime to which all pension plans are subject. In that regard:

- What impediments exist under federal tax legislation to the implementation of desirable changes in pension standards?
- Are there other tax law changes that should be implemented?

Discussion

The *Income Tax Act* (Canada) (ITA) regulates virtually every aspect of the permitted funding of pension plans in Canada and the benefits that may be provided from them. In essence, the tax rules create a "ceiling" on contributions and benefits provided by registered pension plans in order to limit tax deferral opportunities. Pension standards legislation provides the "floor" by setting minimum standards for benefits and funding. Pension plans must operate between those two sets of limits.

The ITA and its regulations contain a prescriptive regime of rules that must be adhered to in order for pension plans to achieve and maintain registration for income tax purposes. Without registration under the ITA, contributions made by both employers and employees are not deductible for income tax calculation purposes, the benefits provided to employees would not receive deferred tax treatment and income on investments held within the plan would be taxed immediately. These features are fundamentally important to sponsors, pension plan members and the retirement savings system generally.

Accordingly, the implementation of any changes to provincial pension standards legislation in Alberta and British Columbia cannot be made in isolation from the impact or permissibility of such changes under the ITA. Many potential improvements to pension standards cannot be made without corresponding changes to the tax legislation, particularly in the area of plan funding.

The federal government must weigh the potential benefits of any proposed change to pension standards against the impact on the tax base that may result from any corresponding change needed under the ITA. Where there is a negative impact on the tax base, the proposed change could encounter resistance from the federal government unless the merits of the desired tax changes outweigh the negative impact from an economic or social policy perspective.

Obviously, it is beyond the power of the Alberta and British Columbia governments to bring about changes to the ITA needed in order to implement recommendations of the Panel in respect of pension standards. However, the two governments can play an important role in engaging the federal government in dialogue necessary to bring about such changes.

In submissions made to the Panel, a number of issues were raised concerning the ITA. There was a unanimous call for increases to the maximum funding rules under the ITA, to enable better long-term funding of DB pension plans. Concerns were also expressed that the maximum contribution and benefit limits permitted under the ITA continue to place Canada at a disadvantage in competing for talent with competing economies, such as the United States and the United Kingdom. Changes to the maximum transfer value rules to allow greater tax-deferred transfers out of pension plans into other tax-deferred vehicles within "rollover" limits were also suggested. The argument made was that the limits were set in an era of higher interest rates when commuted values were lower and no longer allow for the full value of benefits earned to remain tax-deferred even though the benefits are well within allowable limits.

Panel Perspectives and Recommendations

The Panel strongly encourages the governments of Alberta and British Columbia to engage the federal government in dialogue concerning the status of the pension system in Canada and the need for substantive changes in order to broaden coverage and promote the health of the retirement income system. Doing so clearly benefits the federal government by reducing reliance on social programs in the "first pillar" of the system, such as OAS/GIS.

The approach to pension standards legislation advocated by the Panel in this report calls for increased flexibility in the design of pension plans. New designs that meet the objectives of employers and employees may not fit squarely within existing tax rules, though by meeting the principles of general application to all pension plans they should still fundamentally meet the policy objectives of pension plans. Additional flexibility in the tax system to accommodate such designs may well be necessary.

The Panel's approach to funding of DB and SCTB plans also calls for increasing the amounts that may be funded to higher levels than are currently permitted by the ITA. The policy objectives of doing so seem, to the Panel, to far outweigh any tax policy objections. In formulating its recommendations on plan funding, the Panel has been cognizant of concerns that employers might be incented to reduce their taxes by overfunding pension plans and has included in those recommendations measures to address that issue.

The Panel recommends that:

10.1-A The governments should actively advocate that the federal government change various tax rules that impact the pension system, including:

- **raising the maximum contribution/benefit limits (to be more competitive with other major industrialized economies with which we compete for human resource talent)**
- **raising the maximum funding limits for DB plans to encourage more generous funding of such plans and improve benefit security, by allowing surpluses of up to 25 percent, except for Individual Pension Plans, where the current ten percent maximum excess would remain**
- **advocating any changes required to federal tax and bankruptcy and insolvency laws to support establishment of the Pension Security Fund**
- **updating the rules applicable to the maximum transfer values for DB to DC plans to allow larger amounts to be transferred tax-free**
- **making the tax rules flexible enough to accommodate new plan designs that meet the principles of general application under next-generation pension standards legislation**
- **allowing contributions by employees to broad-based plans to be deductible where their employer opts not to participate (See Sections 6.3 and 11)**
- **allowing self-employed individuals to make contributions to a registered pension plan**

10.2 Accounting rules

Issues

Recent and announced changes to accounting standards applicable to the sponsors of pension plans have been identified as having a negative impact on sponsors' willingness to continue to provide DB pension plans. In light of this, should the governments attempt to address the impact that such accounting standards are having on the pension system, and if so, how?

Discussion

The recent shift to a "mark-to-market" approach in the Canadian Institute of Chartered Accounts' (CICA) rules applicable to pension plans results in sponsors of DB plans being required to recognize on their balance sheets the impact of plan surpluses and deficits at fixed points in time. These new rules are based on the approach taken in the International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board (IASB).

These changes to the accounting rules are largely driven by the goal of increased transparency in financial reporting by plan sponsors. The thinking is that shareholders and the public markets are entitled to know at regular intervals what impact the pension plan has on the sponsor organization's financial position.

However, the inherent volatility in DB plan funding under current rules results in sponsors being required to recognize that volatility in their financial results regardless of the fact that, for example, deficiencies can be funded over time, or that valuations are based on assumptions that may or may not prove accurate in the fullness of time. Required recognition of that volatility acts as a disincentive to the establishment and maintenance of DB plans for employers required to comply with such accounting rules. There is also unequal treatment between DB plan sponsors which are publicly traded and must publish financial statements, and those which are privately held and do not have to disclose such results.

Critics of the changes also argue that the rules are inappropriately focused on short-term results, which is inconsistent with the long-term nature of DB pension plans and their funding and investment strategies.

Panel Perspectives and Recommendations

The Panel is concerned that the accounting rules may have been settled upon without full discussion of their implications for sponsors of DB plans and the impact of the rules on the willingness of sponsors to establish and maintain such plans.

The Panel recommends that:

10.2-A Canadian accounting standards should not follow IFRS standards for reporting on DB plans.

10.2-B The two governments should re-engage the CICA in discussions on the impact of accounting rules changes on plans and the adoption of the IFRS standards in Canada.

10.3 Division of pensions on spousal relationship breakdown

Issues

The interrelationship between pension standards legislation and matrimonial property legislation, and related issues surrounding the fairness of the method of division of a plan member's benefit, have resulted in significant complexity and debate in an area not directly related to the reasons that sponsors establish and maintain pension plans. Issues to be considered in resolving this debate include:

General legislative framework issues:

- Where should the rules reside (e.g. in British Columbia, *Pension Benefits Standards Act* or *Family Relations Act*)?
- Should the two provinces' rules be harmonized?

Specific provisions:

- Should the standards require immediate settlement (on marriage breakdown) or deferred settlement (when a benefit becomes payable to the member) or both and if both, should the two methods be available at different times or for different types of pension plan?
- Should the spouse's payment be limited to 50 percent of pension accrued during marriage?
- Should the legislation prescribe a standard pension division agreement or order on marriage breakdown?

Discussion

Pension division on marriage breakdown is now legislated to varying degrees in all Canadian jurisdictions, but most provisions did not come into force until the mid-1980s. The understanding of a pension as an asset, and then further as a matrimonial asset, was evolving during that time. As well, until the mid-1980s, there was no requirement in pension standards legislation for married persons to choose a form of pension with a survivor benefit. The adoption of spousal protection further strengthened the concept of spousal entitlement to a share of the pension. Several landmark court cases established the common law principles; these often found their way into statute.

Even with inclusion of the principles of spousal protection and sharing of the matrimonial asset in the legislation, the principles were at first very general. For example, the Alberta legislation simply stated that the right of a plan member to receive a pension is subject to any matrimonial property order affecting that pension.

Gradually legislators became convinced of the need for more explicit rules. The first explicit rules came into force in Alberta in 2000, with minor modifications in 2006. In British Columbia, the provisions came into force in 1995. Today, in British Columbia, the division of pension benefits upon marriage breakdown is governed predominantly by the *Family Relations Act* (FRA)[63] with related regulation.[64] The act divides property only between *legally married* spouses; however, an unmarried person in a common-law relationship may be able to establish an interest in another's pension if he/she can establish a constructive trust. In Alberta, the *Matrimonial Property Act*[65] also applies only to legally married persons. Under that act, pension benefits are considered jointly accrued matrimonial property; however, the benefits are dealt with by Part 4 of the *Employment Pension Plans Act*[66] (EPPA) and the corresponding part of the regulations.[67] Claims of unmarried persons to an interest in another's pension would need to be established under other common law or trust principles.

The lack of harmonization of legislation addressing pension division on marriage breakdown extends beyond the two pension benefits standards statutes. This reflects a basic difference in approach: is this primarily a pension benefit issue or a matrimonial asset issue? The answer to that question tends to drive some of the decisions about the rules. Although legislators attempt to balance interests of different parties, nuances in the rules indicate whether the primary consideration was rights and flexibility for the divorcing parties, or protection of pension entitlements and the pension fund.

In this field, unlike some other aspects of pension law, there has been substantial pressure for explicit rules from various parties to the pension system. Plan administrators have asked for certainty regarding their obligations and the rights of members and their ex-spouses, and the right to charge for the administrative costs of division and distribution. Family law practitioners have asked for explicit statements of the right to a division and distribution on marriage breakdown and for flexibility in the choices offered to the divorcing spouses. Both plan administrators and family law practitioners have asked for

[63] *Family Relations Act*, RSBC 1996, Chapter 128.
[64] *Division of Pensions Regulation to Part 6 of the Family Relations Act*, BC Reg 77/95.
[65] *Matrimonial Property Act*, RSA 2000, Chapter M-8.
[66] *Employment Pension Plans Act*, RSA 2000, Chapter E-8.
[67] *Employment Pension Plans Regulation*, AR35/2000.

clear rules about how to calculate entitlements. Some would also like a statutory answer to the question of what is a fair division between the divorcing spouses.

It appears the main issue of contention for pension division on marriage breakdown is whether deferred or immediate settlement will be mandated. The deferred settlement method is preferred by some for DB pension plans because it allows the spouse to reap the benefits of changes to the benefit value that occur after the marriage. Others argue that such changes should not accrue to a spouse after a divorce occurs – the model preferred by these people is analogous to a termination of membership in a pension plan, which generally results in no further increases due to benefit or salary escalation. Some submitters argued that the former method is appropriate for DB plans (particularly final average salary plans) while the latter is appropriate for DC plans.

Plan administrators tend to prefer immediate division and distribution to the creation of a quasi-member status for the non-member spouse, because of the administrative simplicity, but this is not a unanimous view. For example, in Alberta, public sector plans often prefer the deferred settlement method because it more accurately reflects the promise of the final average salary plan. This highlights important related issues concerning the valuation of the pension asset, including at what date it is valued for division purposes and whether the effects of any potential future events are taken into account. It has also been noticed by knowledgeable family law practitioners that there is a dramatic difference between the termination and retirement value of these entitlements to the ex-spouse, especially in a final average salary plan, and those people generally prefer the deferred settlement method. Some would like the best of both worlds by obtaining the value that would be generated by the deferred settlement method, but delivered at the time of marriage breakdown. This clearly would not be favoured by plan administrators.

A report of the British Columbia Law Institute (BCLI) from May, 2006, and an ongoing consultation process commissioned by the British Columbia Attorney General, clearly favour the use of the deferred settlement method for division of benefits in DB plans, and the Attorney General's office has published a number of proposals for consideration. A report released by the Law Commission of Ontario in September, 2008, takes the contrary position and favours the immediate settlement method.

Another area meriting attention is whether the spouse should be eligible to receive over half of the pension entitlement. Family lawyers tend to like the most flexibility for settling their clients' affairs, but alienation of more than half the pension benefit conflicts with the longstanding pension standard that pensions should not be voluntarily or involuntarily alienated from members.

A third subject is what form the document authorizing the pension division should take: an order or agreement under the relevant family law statute, or perhaps a standard order prescribed under that act or the pension standards legislation.

Panel Perspectives and Recommendations

Pension standards legislation is primarily concerned with the governance and administration of the pension plan in delivering the pension promised to the member. In the Panel's view, the "fairness" argument inherent in the debate over the appropriate method of pension division on marriage breakdown is beyond the scope of pension standards legislation and delves into the area of family law and social policy relating to family issues.

The rules around pension divisions originally resulted from a perceived need to protect spouses' (primarily women's) rights to family property on divorce. The issue has become even more complicated with common law spouses and same-sex spouses. Some of the original rationale for the division rules seems less applicable today, while the issue of fair or appropriate division of family assets remains.

Whatever the right answer is on the fairness question, the Panel is concerned that the imposition of administrative and cost burdens on the plan administrators resulting from the current division rules is one of the many factors that drives sponsors away from establishing or maintaining pension plans. These burdens were specifically recognized in the report of the Law Commission of Ontario.

The Panel acknowledges the differences that presently exist between the manner in which legislation in the two provinces deals with this issue. In Alberta, the current EPPA provisions were meant to address the obligations of the administrator, rather than what would ultimately be the fairest division methodology. However, in British Columbia, the approach taken has focused on the family relations aspects of the division, rather than the pension plan administrator. The mandate of the Panel extends only to matters concerning pension standards, but in this area there is inevitable overlap into areas outside the Panel's mandate.

The Panel also acknowledges the significant work that has been undertaken by the BCLI and British Columbia Ministry of Attorney General, the Alberta Superintendent of Pensions' office and the Law Commission of Ontario. In the context of the Panel's review, it has relied extensively on the work done in all three provinces.

Taking all of this into consideration, the Panel has these comments:

- The matter of pension division rules involves significant issues of social policy that neither are, nor should be, resolved solely in pension standards legislation. These issues include the "fairness" of valuation and division methodologies, the choice between the immediate settlement method and the deferred settlement method, and the potential entitlements of common-law and same-sex partners to the benefits of pension division rules.
- The Panel, consistent with its other recommendations in this report, supports the harmonization of rules relating to pension divisions between Alberta and British

Columbia, but recognizes the additional complexities raised by virtue of the rules being housed in different types of legislation in the two provinces.

- For DC plans, the only logical approach should be for division to be carried out under the immediate settlement method, as nothing remains in the "promise" to the spouse following marriage breakdown to justify deferred settlement. Considerations regarding the valuation of the member's entitlements also favour immediate settlement, as an account value can be readily determined at the time of marriage breakdown, whereas the value can be muddied by the impact of future events if the former spouses' assets remain commingled after that time.

- Valuation issues and the debate between deferred versus immediate settlement are really only of concern in DB plans and target benefit plans. From a pension standards legislation approach, and being cognizant of the goals of minimization of unwarranted complexity and encouraging broader pension coverage, the Panel is intuitively drawn to the relative simplicity of the immediate settlement method for plan administration, absent any consideration of the fairness of one approach over the other for the spouses involved. However, for target benefit plans, there is some appeal to deferred settlement, since the ultimate benefit to be delivered by the plan is not known at the date of marriage breakdown and could ultimately be more or less than the target, so immediate settlement may either penalize or provide a windfall to either the member or the spouse. Even for DB plans, immediate settlement leaves the member spouse with the entire risk of future adverse events affecting the benefit (such as sponsor bankruptcy while the plan is in deficit).

The Panel recommends that:

10.3-A Pension division should be made using the immediate settlement method for benefits from DC plans.

10.3-B However the issues surrounding the choice between the deferred and immediate settlements for DB and target benefit plans are resolved, any solution should recognize the social policy of pension coverage and take into consideration the role of the plan sponsor and the impact of the rules on the sponsor and the pension plan. The objectives should be to remove barriers to the maintenance of plan coverage and simplify administration from the perspective of pension plans and plan sponsors, while respecting the character of a pension benefit.

10.3-C Pension standards legislation should make clear that the costs incurred in effecting the division, including professional fees and any ongoing incremental administration costs, should be borne by the member and spouse, and not by the plan (and, by implication, the other members) or the sponsor, on the basis that relationship breakdown and its implications are neither the plan's nor the sponsor's issue, and they should not be unduly burdened as a result.

10.3-D Next generation pension division rules, in whatever legislation they may be housed, should:

- **be simple and easy to administer on the part of the plan administrator;**
- **not require the exercise of discretion or judgment by the plan administrator in interpreting orders or agreements;**
- **not require the administrator to obtain professional advice;**
- **not impose positive obligations on the sponsor or administrator beyond provision of specified information and the payment of benefits that the order or agreement requires be paid;**
- **be based on a clear, straightforward formula using a standard form of "fill in the blanks" order that it is easy for the parties and their counsel to understand and practical for the administrator to manage; and**
- **prescribe the form of pension division addendum to any matrimonial property division order or agreement contained in either pension standards or family relations legislation.**

10.3-E If the spouse is to be entitled to become a "limited member" of the pension plan, that status should be granted for the purpose of collecting benefits described in the property division order or agreement only, and not for any other purposes. Such limited members should be entitled to receive annual statements such as those provided to the member spouse in respect of the limited member's benefit entitlements under the pension plan. After receiving the full payment of the benefit required by the property division order or agreement, the spouse should have no further claim under the plan.

10.3-F Pensions standards and family property legislation should confirm the ability of the parties, by agreement, to contract out of pension division and decide on an alternative approach to dividing their family assets.

10.4 Bankruptcy and insolvency

Issues

In light of several high-profile cases in Canada in recent years involving underfunded pension plans of insolvent employers, issues surrounding entitlements of pension plan members in cases of business insolvency and the ineffectiveness of deemed trust provisions in pension standards legislation have gained prominence. Topics to be considered include:

- If a pension plan is underfunded in the event of business insolvency, should it have the ability to obtain funds from the employer's assets?
- If yes, what should be the priority level of pension funds in obtaining funds from assets?
- What amounts should be claimable?
  - due but unpaid contributions?
  - outstanding solvency deficiencies?
- Should pension funds have the same priority as unpaid wages or vacation pay?
- Should there be a pension benefits guarantee fund in Alberta and British Columbia?

Discussion

What happens to a business' pension plan in the event of insolvency depends on what kind of pension plan was being operated. DC schemes are relatively simple – all that is required is figuring out how much is in each employee's account and paying it. DB schemes, by contrast, are more complicated. If the fund has a surplus, a decision has to be made as to who owns the surplus. Employees may try to claim the surplus as theirs to enhance their benefits while creditors may argue it belongs to the employer in order to put it towards the employer's debts. While surpluses can be contentious, deficits arguably create a larger problem. If the plan is underfunded, employees will most likely face a benefit reduction. The order of priority of the beneficiaries is set out in pension standards legislation,[68] which has basically eliminated the uncertainty from this issue. The controversial aspect of the proceedings, however, relates to the plan's ability to make claims against the business' assets. While there is general consensus that pension plans should, *at some point*, have a claim against the business' assets, there is debate over the priority the plan should have. Labour groups argue plans should have a high priority and be one of the first in line to receive payments, while other creditors, such as lenders, do not want anyone leapfrogging their secured creditor status and potentially reducing the amount they can recoup. Supplanting other creditors on the priority list could also dampen the availability of credit to businesses that sponsor DB pension plans, thereby creating another disincentive to sponsoring such a plan.

Complicating matters further is the fact that there can be two separate and distinct kinds of underfunding. First, there can be unpaid contributions – those contributions, usually a few months' worth, that an employer did not pay either as it was heading towards bankruptcy or after filing. Second, there can be solvency deficiencies outstanding at the termination. This is the amount by which the plan falls short of being able to cover its full liability for benefits at termination. As unpaid contributions are usually less than the solvency deficiencies, it is often easier for these amounts to be recouped by the pension plan. It is

[68] EPPR s. 55; PBSR s.39.

also often more justified because the contributions were clearly due but not paid, whereas payments would not have been due until after the insolvency on the remaining solvency deficiency.

Arguments in favour of increasing the priority of pension plans often centre on the rights of the employees. First, it is argued that pensions are essentially deferred wages and therefore should be treated in a similar manner. Second, employees should be protected because they face an undue amount of risk as they are not diversified: their current and future wages all depend on the same employer. Related to this is the notion that employees are in fact creditors of their employer by virtue of having forgone wages in exchange for the promise of future pension entitlements. Thus, these arguments suggest that the goal of legislation should be to protect employees due to the power imbalance between employer and employee and as between an employee and a creditor. (For example, a bank can check the credit history of a company before lending money, while employees are not often in a position to do so or, even if they can, inclusion of pension plan participation as a term of employment makes the matter moot.) Another inequality that exists is that employers may reduce pension benefits without even going into bankruptcy by using the threat of bankruptcy to get employees to renegotiate pension benefits or as a reason to take contribution holidays.[69]

Arguments against raising the priority of pension plans focus on the disruptive potential such a change could have on the marketplace. If pension plans were given more priority, it would lower the priority of other creditors, potentially reducing their access to a finite amount of assets. This risk could cause creditors to either stop lending money or to lend money at a higher rate of interest. It could also saddle lending institutions with large unpaid debts or liabilities.[70]

Prioritizing unpaid contributions, solvency deficiencies or both also raises the same concerns. Raising the priority of both would offer the most protection to employees; even in the event of their employer's insolvency they would be likely to receive their full pension. However, this would also have the greatest chance of reducing creditors' chance of recouping their money and therefore offer the greatest chance of market disruption. Prioritizing only one (most likely the unpaid contributions) would fully protect neither creditors nor employees, but would be a compromise. Another compromise would be to include due but unpaid special payments for funding shortfalls in super-priority status.

An alternative way to deal with the problem of underfunded pension plans at bankruptcy would be to reduce the possibility of having underfunded pension plans in the first place. This could be achieved through stronger funding requirements that would ensure plans remain fully funded. The problem with such legislation is that forcing a struggling

[69] Fiona Stewart, "Benefit Protection: Priority Creditor Rights for Pension Funds" *OECD Working Papers on Insurance and Private Pensions,* No. 6, OECD Publishing. http://www.oecd.org/dataoecd/39/0/37977393.pdf at 6 [Stewart].
[70] Stewart at 8.

company to continue making full pension contributions may actually increase the chances of it becoming insolvent.

Another alternative that could help address the problem would be to require the receiver/trustee in bankruptcy to notify the superintendent of any insolvency proceedings involving a company with a DB plan. Such notice could allow the superintendent to start winding up the plan and dispersing benefits before it becomes increasingly underfunded.

A final alternative that has been employed with mixed results in other jurisdictions is the use of a “pension benefit guarantee fund” structure to compensate members of pension plans whose benefits are reduced as a result of underfunding in a pension plan upon plan sponsor insolvency. This type of insurance-like scheme is typically funded by additional contributions from employers who sponsor DB plans and such additional costs could act as a further disincentive to sponsoring such plans. In certain high profile cases in Ontario, the fund was unable to satisfy its obligations to the members under the legislation and required additional funding from government in order to pay entitlements, thereby spreading the cost beyond those involved in the provision of pensions to taxpayers generally. An argument also exists that the existence of such a vehicle can act as a disincentive for sponsors to fund their plans conservatively due to the perceived “safety net” for the plan members provided by the guarantee fund.

Panel Perspectives and Recommendations

In considering the array of options potentially available to address these issues, the Panel is concerned that any changes that might be made could be perceived by business lenders and other creditors as overly onerous and disadvantageous to what they have always understood to be their secured creditor position. If any rule change had this effect, it could significantly dampen the availability of capital and other credit to businesses which sponsor DB pension plans and could result in pressure for such businesses to abandon those plans. This would be particularly so if priorities around unfunded liabilities or solvency deficiencies were impacted. As a result, rules designed to protect plan member and retiree interests could have the unintended consequence of, in fact, harming those members.

The Panel is supportive of the amendments to the *Bankruptcy and Insolvency Act* (Canada) that came into effect in July, 2008, which provide “super priority” secured charges in respect of:

- any deducted but unremitted employee pension contributions;
- any unpaid employer "normal cost" DB contributions that were required to be paid to the pension fund pursuant to pension legislation applicable to the pension plan; and

- any unpaid employer contributions that were required to be paid to the pension fund pursuant to the terms of a DC provision and the pension legislation applicable to the pension plan.

This means that, while the priority of unpaid contributions will go up, the priority of unfunded liabilities (solvency deficiencies, as they are called when valued as at plan termination) will remain the same. That said, providing secured creditor status for such unpaid contributions is more effective than in the past and treats unpaid pension contributions more as unpaid wages are treated.

In Section 8 of this report, the Panel has made numerous recommendations concerning the funding of DB and target benefit plans which are designed to improve the funded status of plans and benefit security for members. If implemented, these recommendations should greatly assist in minimizing instances when plans have significant deficiencies at the time of sponsor insolvency, without disrupting the priority of creditor claims. However, those proposals are not intended to require full funding at all times. While the appeal of continuous full funding to members and pensioners is obvious, the very nature of DB plans makes the concept impracticable. In the Panel's view, more frequent solvency testing and more onerous funding rules beyond those recommended in Section 8 would be more likely to act as disincentives to the establishment and maintenance of DB plans than to protect member and pensioner interests.

The Panel also does not support the establishment of a pension benefit guarantee fund in Alberta and British Columbia. The Panel's perspective is that the costs of maintaining such a fund at a level sufficient to adequately meet its potential liabilities would be better directed towards the proper ongoing funding of pension plans in accordance with the Panel's recommended approach to funding. The Panel is also concerned with the disincentive effect that the existence of such a vehicle may have on conservative funding by plan sponsors.

The Panel recommends that:

10.4-A There should not be a pension benefit guarantee fund established in Alberta and British Columbia.

10.4-B The governments should encourage the federal government to extend the "super priority" secured creditor status to all due but unpaid contributions, including solvency deficiency or unfunded liability special payments, but not to extend such status to such amounts that are unamortized but not yet due.

10.4-C The governments should encourage the federal government to provide the PSF with the same treatment under federal bankruptcy and insolvency legislation as applies to the regular pension fund of a pension plan. (See also Section 8.1.1 "DB funding rules" above.)

10.4-D The deemed trust rules in pension standards legislation need to be clarified to ensure that monies held for pension contributions are treated in the same manner as earned but unpaid wages under provincial employment standards legislation and, in situations other than bankruptcy, are not available to satisfy other creditors.

10.5 Financial education and literacy

Issues

Some have said that people seem to be demonstrably less successful at preparing financially for retirement if left to their own devices. In today's environment, where most people do not have a pension plan, and those who are lucky enough to be eligible for one are often still faced with a number of daunting decisions, financial literacy is all the more important. As mentioned in Section 2.2.2 above, the 2007 federal budget highlighted financial literacy as a priority, emphasizing that Canadians must have the information they need to make sound financial decisions. While it has always been an advantage, having some basic "financial life skills" is rapidly becoming a necessity without which exposures to economic risk and loss are ever more threatening. It seems that it is increasingly critical for individuals to plan for the future, and the need for the basic knowledge required to make informed decisions regarding spending, saving and investing is greater than ever.

Discussion

In our discussion paper we asked for views on whether financial literacy is a problem that governments should be addressing. Those who responded on this topic were unanimous in their opinion that something must be done and that it is up to government to do it. Of 13 stakeholders that commented, 11 recommended that financial education should be part of the public school curriculum. Others suggested that government could raise awareness through a financial literacy campaign, or could encourage employers to provide financial education to their employees with government incentives. One submitter pointed out that it should not be the responsibility of employers or plan administrators to provide general financial literacy skills to their plan members.

Research shows that some governments, including Canada, have taken the initiative over the years to address financial literacy, but progress is slow and difficult to measure. The United Kingdom introduced the "Savings Gateway" and "Child Trust" programs early in this decade ensuring that they included a significant public sector commitment to financial literacy. Around the same time, the United States Compliance and Consumer Affairs Division of the Federal Reserve Bank and the Department of Labor joined forces to launch the national "Financial Services Education" campaign. The United States Department of the Treasury contains an "Office of Financial Education" which claims to facilitate dialogue on economic education and financial literacy. The United States Department of

Education suggests that it is engaged in an ongoing effort to improve financial education among school-age children.

In 2004, the British Columbia government added a mandatory course on financial literacy to the grade 10 educational curriculum. The 20-hour module, which is part of a larger program called Planning 10, includes information about income, expenses, budgets, savings, banking, credit, debt, insurance, investing and financial planning. The British Columbia Securities Commission (BCSC), which was instrumental in developing and promoting the course, also has an active program to market it to British Columbia teachers. The Panel has been advised that the course is considered to be successful – but ironically, one of the main problems has been finding teachers that understand how to teach financial literacy to high school students.

There is considerable evidence that such educational programs are effective. An evaluation conducted by the United States National Endowment for Financial Education on its high school-based programs found that participation in financial-planning programs improved students' knowledge, behaviour, and confidence with respect to personal finance, with nearly half of participants beginning to save more as a result of the program. Other studies of the relationship between financial behaviour and financial outcomes suggest that comprehension of the general principles of sound financial behaviour, such as budgeting and saving, are actually more beneficial in producing successful financial results over time than specific and detailed information on financial transactions. As noted by the former Chair of the United States Federal Reserve, Alan Greenspan:[71]

> These findings underscore, in particular, the importance of beginning the learning process as early as possible. Indeed, in many respects, improving basic financial education at the elementary and secondary school level is essential to providing a foundation for financial literacy that can help prevent younger people from making poor financial decisions that can take years to overcome. For example, through a fundamental understanding of the mathematics of compounding interest, one can appreciate the cumulative benefit of routine saving.

Panel Perspectives and Recommendations

Financial literacy is a critical element of the retirement system – without it, people cannot understand many of the forces that significantly affect the quality of their lives, and are not equipped to make decisions suitable to their personal situations.

The Panel is particularly concerned about the apparent lack of the fundamental skills required for budgeting and managing household finances. In particular, when it comes to pensions, we believe that a basic level of financial literacy is required to plan and save for retirement. Increasing financial literacy may be one of the most critical methods for enhancing the ability of households to save and accumulate the assets required to protect against poverty. A solid background in basic financial principles has been shown to

[71] Excerpts from remarks by Fed Chairman Alan Greenspan at the Community Affairs Research Conference of the Federal Reserve System, Washington, D.C., April 6, 2001.

increase household wealth in later years – and financial literacy also increases economic opportunity along the way, by enabling individuals to take better advantage of opportunities as they arise.

People need the skills and knowledge to ensure they know how best to use and make decisions regarding financial services at different stages of life. In the early years, young people need to become familiar with basic principles such as income, expenses, budgets, savings, banking, credit, debt and the "time value of money." As they mature, people are faced with making decisions regarding housing and educating their children. They will make some of the largest investments of their lives – and will need more detailed information on issues like mortgages, car loans, insurance, investing, and financial planning. And as they near their retirements they will need yet other types of knowledge, such as how to realize on their investments, when they can consider retirement and when and how to apply for government pensions. Adult consumers need appropriate, unbiased, accurate information to make informed decisions, and they need the skills to locate, absorb and apply this information to their own circumstances.

The potential benefits of improving financial literacy in British Columbia and Alberta are significant, including helping to:

- contribute to more informed consumerism;
- increase the number of children that proceed to post-secondary education;
- reduce dependency on public assistance;
- prevent consumers from falling victim to financially devastating credit arrangements;
- contribute to the accumulation of wealth and assets – including home ownership; and
- increase the capacity of people to save for contingencies and retirement.

The Panel applauds the efforts of the BCSC to educate the public on financial matters and, in particular, to bring financial education into the secondary schools in British Columbia. While we understand that the BCSC is building on its work with the FCAC, we believe that the governments need to do more. Improving financial literacy is one of those things that we cannot afford not to do.

The Panel recommends that:

10.5-A The governments should work to build and expand on existing programs, and explore opportunities for earlier introduction of financial skills education in the public school system. Due to the importance of early education, we recommend expanding financial life skills instruction to the primary school level and that it be a regular component of curricula throughout the public school years.

10.5-B The governments should work to ensure that teachers are properly equipped to teach financial literacy skills.

10.5-C There should be a clear mandate within the governments for improving consumer education and financial literacy, including government-led "financial literacy campaigns", and a comprehensive strategy for adult education in financial skills.

11.0 The "ABC Plan"

This section of our report does not directly relate to specific EPPA/PBSA standards recommendations. Rather, this section answers, in part, one of the Panel's fundamental questions in our discussion paper, namely, "What role, if any, should occupational pension plans play in the Alberta and British Columbia retirement income systems?"

In reviewing answers to the above question and listening to our stakeholders, it became apparent to the Panel that the establishment of an occupational pension plan available to all Alberta and British Columbia workers would be well received by employers and employees alike and should significantly address the issue of how to increase pension plan coverage for the private sector in our two provinces. Details of the design will not be addressed other than to set forth suggested design parameters and alternatives to elicit further study by the two governments (perhaps via a jointly appointed Steering Committee) in order to create what the Panel calls the Alberta/British Columbia Pension Plan (ABC Plan).

This section of the report will address the following areas:

- Key considerations of an ABC Plan
- ABC Plan design
- Implementation of ABC Plan

Issues

Participation of workers in occupational pension plans is in decline in Canada. As noted in Section 2.1.1, recent statistics indicate that only 22 percent and 23 percent of British Columbians and Albertans, respectively, employed in the private sector are covered by any form of occupational pension plan. Moreover, recent statistics indicate that personal savings rates in Canada have been in general decline since 1982, and estimates indicate the average family will have substantially less than the 70 percent of retirement income replacement believed by many to be required to maintain a sufficient standard of living in retirement. Moreover, given that the debt loads of Canadians are at an all-time high, which the Panel and others suggest will continue to result in Canadians neglecting to save adequately for their retirement, the introduction of a cost-efficient, professionally-managed pension plan available to all workers in our provinces may help reverse these troubling economic trends.

Recent catastrophic declines in the stock market are likely to have a negative impact on Canadians' savings, including the security and/or viability of their employers' pension plans. The need for a cost-effective pension plan is clear, not only to serve workers, but also to address the anticipated need for an increase in capital available for infrastructure projects and ongoing capital investment in Canadian businesses.

Other drivers towards the establishment of an ABC Plan are demographic in nature. Both provinces are working on strategies for our acknowledged aging society. The need for encouraging Canadians to save for retirement as well as keeping those wishing to work past normal retirement age in the workforce has created an opportunity as well as a challenge for our provinces. We submit that the ABC Plan would go a long way to addressing both the coverage challenge and the need to accommodate older workers.

While many employers in Alberta and British Columbia have and will continue to provide well-funded and administered DB and DC plans as well as a combination of DB and DC arrangements, many others have made the decision to either convert their DB plan to a DC arrangement, terminate their pension plans or not to provide any pension coverage at the outset of their operations in our provinces. Other employers who acquire existing businesses in our two provinces often decide not to assume responsibility for pension plans. In some cases, vendor companies are forced to wind up their pension plans leaving their former employees without the benefit of further pension accruals subsequent to the purchase of their employer company. In other words, many employers in our provinces wish or are forced to "get out of the pension business" due to the significant administrative, legal, economic and regulatory challenges inherent in providing not only a DB plan, which can impose considerable risk on the employer who is obligated to deliver guaranteed benefits, but even a DC arrangement, which was once considered a simple, low risk alternative for employers.

Accordingly, the Panel has come to the conclusion that immediate steps must be taken to examine the feasibility of establishing a multi-employer pension plan available to all workers in our provinces for which individual employers would not have any fiduciary responsibility. The objectives and suggested design of the proposed ABC Plan are modeled, in part, on pension plan designs that already exist in Canada and elsewhere in the industrialized world, and are discussed in Section 6.3 and Appendix B of this report.

Common features of most broadly based multi-employer plans that exist in other jurisdictions[72] are that employers do not assume direct financial risks, employers and employees are either required to participate or they are automatically enrolled in these plans with opt-out rights, and delivery of the pension is institutionalized in a transparent and cost-effective manner operated solely in the best interests of all pension plan participants.[73] Plan members bear the risks associated with normal market volatility but can pool longevity and investment risk after retirement by electing an annuity from the plan. Due to economies of scale, total management and expense ratios for these large

[72] See for instance, Australia's Superannuation plans, New Zealand's "KiwiSaver", the United Kingdom's Personal Account plans, the Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF) in the United States and, within Canada, Quebec's Simplified Pension Plan and Member-Funded Pension Plan as well as Saskatchewan's Co-operative Superannuation Society Pension Plan.
[73] See also Keith Ambachtsheer's 2008 C.D. Howe Institute Commentary, "The Canada Supplementary Pension Plan (CSPP) – Towards an Adequate, Affordable Pension for *All* Canadians".

multi-employer plans are dramatically lower than would otherwise be available to participants in the retail private sector.

Panel Perspectives and Recommendations

Occupational pension plans are important not only for retirement income generation in Alberta and British Columbia but also society generally, to allow both employers and employees to work together to save for retirement, generate capital for investment and decrease reliance on social programs by retirees. The decline in pension coverage in the private sector is alarming to most stakeholders we heard from. This decline in coverage is a crucial economic challenge facing both our provinces.

Governments can play a role, not only through modernizing pension standards legislation but also through other policy initiatives directed squarely at expanding pension coverage in our provinces. The objective of most current pension legislation is member protection and, while such protection is important, it should not be the only goal of the legislation nor should it be permitted to impede what the Panel believes is the more significant goal of broader pension plan coverage in our provinces. As discussed in Section 6, the interests of workers are not protected if they have no pension plans. The governments should keep in mind that they can play a role in promoting pension plans as they absorb this report, consult with stakeholders and make decisions on next steps.

The Panel is also of the view that employers who do not currently sponsor a pension plan should be strongly encouraged by government to participate in the ABC Plan in order to facilitate maximum participation in our provinces. A material increase in pension coverage in our provinces would:

- benefit employees by improving their retirement financial security;
- benefit taxpayers including employers by reducing the burden on tax-supported income security programs; and
- increase the capital available for investment in business and infrastructure.

11.1 Key considerations for an ABC plan

The objective of the ABC Plan would be to make it easier for employers and their employees to participate in a cost-effective pension plan; it would have sufficient economies of scale to allow all Albertans and British Columbians to access high quality investment management expertise as well as plan administration services at costs comparable to those currently enjoyed by the public sector and other large pension plans in our provinces. With sufficient economies of scale, the ABC Plan could be substantial enough to support state-of-the-art governance arrangements and investment management services. To be successful, total management expense ratios, including plan administration costs, should not exceed 0.5 percent of assets under management.

Currently, these low expense ratios are available only to large (generally public or semi-public sector) pension plans.

The other key objectives of the ABC Plan would be to substantially increase coverage of occupational pension plans in the provinces as well as improve retirement income security. By pooling longevity and investment risk together with a pension administration delivery system designed to encourage seamless participation by employers and employees at very low administration cost, those with no occupational pension plans and inadequate savings could begin saving for their retirement under a far more cost-effective and member-focused model. Another objective, of course, would be to accumulate greater capital.

Employers in our provinces would, we suggest, welcome such an ABC Plan provided it could truly deliver on the key objectives noted above. Many employers find the administration of a pension plan a distraction from their primary goal of delivering goods and services to their customers. We submit that the notion that employers believe they must provide a pension plan as an attraction and retention tool has significantly less merit today than it once had due, in part, to the fact that the time and resources required by employers to provide pension plans, coupled with the increasing regulatory complexity and liability associated with these plans has made this unilateral decision to provide a pension plan one which many employers wish to avoid or off-load. This is not to suggest that employers in our provinces do not wish to ensure that employees are saving for and have adequate retirement income as clearly the submissions we received indicate employers care deeply about providing for and assisting their employees with retirement savings. Therefore, the key objective for an ABC Plan would be to broaden pension coverage by making it easier to access by all workforce participants.

One plan for our two provinces

We are advocating a single plan for the two provinces. Duplication of effort in the two provinces would be less efficient in all respects. In keeping with our mandate, a single plan would enhance harmonization, pension portability and labour mobility between the two provinces and maximize the advantages of scale. It would also provide a strong foundation for potential future inclusion of other provinces in the Plan.

The ABC Plan would address one of the Panel’s key terms of reference, namely ensuring that Alberta and British Columbia are leaders in creating opportunities and choice for workers, investors and businesses by easing the burden of costs associated with sponsoring occupational pension plans. Moreover, the ABC Plan would play a significant role in attracting and retaining the future workforce in our provinces and facilitate worker mobility between employers in our two provinces.

Once fully operational, the size of the ABC Plan pension fund would be significant. Assuming wide-spread participation by employers and employees in our provinces, a large pool of capital would be created that could eventually equal and ultimately exceed public sector pension plan assets which currently enjoy access to investment expertise and opportunities not otherwise available to members of smaller private sector plans. This size disparity of pension and investment opportunity between public and private sector workers is cause for concern that an ABC Plan could partly address.

Advantages for employers and employees to participate in the ABC plan

One of the key advantages for employers and employees to participate in the ABC Plan, particularly for those not otherwise equipped or willing to assume the liability and costs associated with sponsoring and participating in their own employer-sponsored pension plan, is that it would provide an opportunity for them to join together in making regular monthly contributions via their existing payroll systems. Those employers and employees could avoid the additional costs and liability associated with sponsoring their own plans. These costs are not only prohibitive for many smaller and medium-size employers, they are often unpredictable. The ABC Plan would largely eliminate these costs for employers in our two provinces, offering a low cost alternative.

Though pension plans have often been regarded as an attraction and retention tool by many employers, several of the stakeholders that the Panel heard from stated that many employers are no longer considering pension plans for this purpose. Consequently, the introduction of the ABC Plan would not, in many situations, be viewed as an encroachment on employer-employee contractual relations. While the ABC Plan could well enhance the employer-employee relationship where there is currently no pension plan, it would not purport nor intend to replace existing plans that employers have established to attract and retain labour by distinguishing themselves from competing employers.

Another advantage of the ABC Plan for both employers and employees is that the risks related to rates of return and target benefits subject to the vagaries of the market, together with risks associated with oversight and selection of investment managers and ongoing regulatory compliance, would be largely mitigated, due to its scale and expert administration and investment management. The guessing and speculation associated with both DB and DC plans, and the risks related to the negative implications for ongoing financial viability of the employer would also be eliminated.

In this regard, another key advantage to both employers and workers would be the confidence that the ABC Plan assets were being invested by an excellent investment management team and at a cost competitive with the investment management and administration fees enjoyed by members of the public sector and other large pension plans. Economies of scale and professional management of plan assets would take the current "distraction" that pension plans often create in the workplace away and thus allow employers and employees to get on with providing the goods and services that their businesses were created for in the first place.

As the ABC Plan would be intended to be a registered pension plan, another advantage for the employer would be that contributions through payroll deduction would not attract payroll taxes such as CPP, Employment Insurance, Workers' Compensation and other earnings-related payroll costs. This is in contrast to group RRSPs, which attract payroll taxes and are often regarded as cost prohibitive for smaller employers. The regular tax deductions for contributions to registered pension plans are, of course, an ongoing advantage for any registered pension plan, including the ABC Plan.

ABC plan eligibility and participation

It is the Panel's position that, while full coverage is desirable, it is not feasible for two provinces to establish a mandatory plan. A mandatory program, to be successful, would have to be national in scope, otherwise the two provinces would be disadvantaged competitively compared to the rest of the country.

Several of the stakeholders that the Panel heard from supported, in principle, the broad outlines of the ABC Plan structure that we discussed with them. Several of the stakeholders voiced support for the auto-enrolment of employers and employees with an opt-out provision. While some others felt strongly that mandatory employer participation was prerequisite for success of the Plan, many of the stakeholders were concerned with declining pension plan coverage, but thought that a voluntary plan with proper incentives to participate was preferable.

Support for auto-enrolment with opt-out stems in part from recent pension legislation in the United States and the United Kingdom. Under the U.S. *Pension Protection Act* there has been an increase in pension plan coverage due to auto-enrolment design features which increase the likelihood that once enrolled, employers and employees tend to continue their participation rather than going through the trouble of opting out of savings plans. Similar auto-enrolment features have been introduced in the United Kingdom. Auto-enrolment was chosen in the United Kingdom because:

> Automatic enrolment into existing stakeholder schemes would go some way to dealing with the lack of demand in the pensions market for our target group, by overcoming the inertia that leads many individuals not to make a decision to save. It would also increase the number of savers and the amount of savings in the stakeholders schemes.[74]

The United Kingdom also considered evidence from the United States that showed auto-enrolment increased pension coverage across the board (for employers with over 20 employees, rates were 60 percent for auto-enrolment compared to 41 percent for opt-in plans). Participation rates were particularly strong among groups with lower coverage, such as lower income workers, ethnic minority groups, and women.[75]

Some of the stakeholders we met with, in particular labour organizations, thought that mandatory participation was key to the success of any such broad-based multi-employer

[74] Department for Work and Pensions, "Personal Accounts: A New Way to Save – Executive Summary" December 2006 at para 17.
[75] Ibid. at para 66.

plan. The view of labour groups was that the Plan would not succeed unless and until employers are required to contribute a minimum amount into the Plan at the outset with flexibility to increase the minimum contribution rate on a case-by-case or negotiated contribution basis.

One stakeholder group suggested that a transitional contribution rate could be considered in the first four years of ABC Plan existence, to enable businesses to adjust gradually. As an example, the KiwiSaver plan in New Zealand required employees to contribute four percent of their wages to the pension fund with the employers initially required to contribute only one percent, escalating by one percent over the next three years in order to match the four percent contribution rate required by employees. While this transitional contribution model has some merit, the Panel is of the opinion that any form of mandatory employer or employee participation would not be acceptable to most employers and employees in our provinces and would not be viewed as a "balanced" solution to expanding pension coverage.

All employers and workers, including the self-employed, earning income from employment or self-employment in either Alberta or British Columbia should be eligible to participate in the Plan. The Panel is recommending that all employers in our two provinces be automatically enrolled in the ABC Plan but the employers and/or their employees should be able to opt out. If the employer opts out, each employee would still be automatically enrolled without employer contributions unless he/she opted out (a double opt-out concept). This would require a system, probably utilizing Canada Revenue Agency data, for identifying employers in the provinces. The Panel supports the concept of a double opt-out because of its implications for higher coverage, but recognizes that there may be implementation issues; therefore, this matter should be considered by the Steering Committee.

Self-employed individuals in our provinces would also be encouraged to participate in the Plan. Auto-enrolment is not recommended – rather participation by self-employed individuals should be on an opt-in basis.

Eligibility for membership in the Plan could be based on a minimum earnings threshold to address those employees who could be negatively impacted by participating in such a plan because of their lack of discretionary income and the future impact of claw-back provisions under the GIS and OAS. Membership would be available to anyone between the ages of 18 and 71 (the latter age being the current maximum age at which the ITA permits continued sheltering of retirement savings).

The Panel advocates making participation compulsory for employees of employers who participate in the plan. We recognize that this poses the risk that a group of reluctant employees could persuade an employer to opt out, but we believe that this requirement would greatly improve participation. However, to address employment situations involving high turnover or seasonal employment, auto-enrolment in the ABC Plan should not apply unless and until employees have become "permanent" under some service-based test criteria. Perhaps one year of full- or part-time employment would make such auto-enrolment more palatable. These design issues should be addressed by the Steering Committee.

The opt-out provision of the ABC Plan is also a key element, particularly for employers who already provide a registered pension plan to their employees or who determine that they simply cannot afford or do not wish to participate in the Plan.

The Panel struggled over the question of mandatory versus voluntary participation and arrived at what the Panel believes is a fair and balanced approach with the auto-enrolment with double opt-out design. That said, the Panel encourages the government (and the Steering Committee discussed below) to explore ways to create incentives, whether in the form of additional tax incentive or other economic incentives, for employers who do not already provide a pension plan, to enrol in the ABC Plan. (See also Recommendation 6.1-C above, regarding such incentives for existing and potential plans other than the ABC Plan.) The economic benefits of wide spread pension coverage in our provinces will be significant for all concerned.

Governance of the ABC Plan

As discussed in Section 7 of this report, one of the salient attributes of a successful pension plan is a governance structure that is effective, strategic and, above all else, operated under clearly understood rules and procedures by a governing fiduciary that possesses the necessary expertise to understand its role and the authority to provide the necessary management to oversee the plan's operations.[76]

Governance of the ABC Plan should be at arm's length from government. The key to the acceptance of and continued participation in the ABC Plan would be full transparency and comfort by the participants that the pension delivery system is operating exclusively for the benefit of the ABC Plan participants and not for any third-party agents such as institutional investors, trust companies and custodians or any other service providers. That is not to say third-party providers could or should not play a role in delivering services to the Plan.

Although the details of the governance structure will require extensive consultation with stakeholders and experts, it is the Panel's view that the plan should be set up on a not-for-profit basis, perhaps structured as a pension society with a board of governors operating at arm's length from government.

There are several models of pension governance that the governments could consider including the governance structures of the Ontario Teachers' Pension Plan, and the public

[76] See Keith Ambachtsheer's "Pension Revolution – A Solution to Pension's Crisis", published by John Wiley & Sons, Inc. copyright 2007, pages 93 – 130.

sector pension plans in British Columbia, as well as other examples discussed in Section 6.3 and Appendix B of this report.

The board of governors of the Plan should comprise, in the majority, true experts in their field with lay representation from both employee and employer stakeholder groups. Lay participants on the board of governors should also be required to obtain training along the lines of the recommendations discussed in Section 7.1.1 regarding trustee education so as to ensure that the lay trustees bring their own experience and special training to the table. A partnership of governance by a combination of trained lay people and experts would foster confidence in the system, as well as ensure that the Plan is operated solely for the benefit of the members and other beneficiaries.

While the Panel does not recommend a large board for the governance of the ABC Plan, it must have representatives from a sufficient number of stakeholder groups including industry experts, management and employee groups to give it the transparency and depth necessary to properly manage the ABC Plan.

Details of the governance structure should be determined by the Steering Committee. However, the Panel is of the opinion that a plan as large as the ABC Plan would likely become necessitates a board that is truly both expert and independent, with meaningful employer and employee representation.

Administration of the ABC Plan

Administrative services for the Plan should be performed by an organization at arm's length from government. Efficient and effective administration would be a fundamental component for the implementation and on-going success of the Plan. Without strong plan administration and payroll systems linkage with all employers in Alberta and British Columbia, the Plan would simply not succeed.

Although we are not advocating government sponsorship or direct long-term investment by respective governments, the development of the ABC Plan will require, at the initial stages, investment by our governments to ensure that the resources, systems and expertise are made available to ensure its successful launch and ongoing operational success. For example, a payroll contribution system for all participating employers and employees would have to be developed, likely through an arrangement with the Canada Revenue Agency.

The administration of the ABC Plan could be publicly tendered. Large institutional administration service providers already exist in our provinces and these institutions may be willing and more than able to provide the administration services for such a large plan at below their current costs given the economies of scale that could be achieved if sufficient numbers of employers and employees participate. However, economies of scale may have to be realized or within reasonable reach before third-party providers might be in a position to offer an appropriate cost structure. Government investment in the system, at least in the early stages of the Plan, may be required to ensure the best possible pension delivery system at an appropriate cost.

Investment of the ABC Plan assets

For the sake of simplicity and to avoid the costs and complexity of offering and educating Plan participants about investment choices, the Panel does not recommend that employers or employees contributing to the Plan have any investment choice. Rather, the Panel recommends that investment of the Plan assets be subject to the policy direction of the board of governors. This would provide the strong governance and risk controls required to ensure optimal results. The investment function could reside with either an existing investment manager or managers, or a statutorily created body operating at arm's length from government. The investment manager(s) would implement asset mix and general investment policy working under the direction of the Plan's board of governors.
Given the likely eventual size of the ABC Plan assets and the long term investment horizon for many of the Plan participants, the Plan's investment strategy could ultimately include auto-annuitization, including spreading out annuity purchases over time to minimize longevity risk and retirement end-date sensitivities. Such a strategy would help mitigate risks of market volatility.

Investment management of the ABC Plan assets could be competitively tendered. As stated above, to be successful, the ABC Plan's total management expense ratios including administration expenses should not exceed 0.5 percent of assets under management.

The investment function of the CPP Investment Board is an example of how the assets of a large multi-employer pension plan should be managed. Although there would have to be legislative changes to their mandates, the investment management corporations established by the two governments, the British Columbia Investment Management Corporation and the Alberta Investment Management Corporation, may already be equipped to offer existing infrastructure and expertise required at least in the initial stages of the ABC Plan investment management. The benefits of using existing institutions are that they already have the economies of scale, access to investment classes, expertise and credibility in the market place that would be necessary to instil confidence amongst participants in the ABC Plan. That said, tendering of the ABC investment management structure should also be considered at the outset.

Custody of ABC Plan assets

Custody of the ABC Plan assets is also another important aspect of the plan's structure. Similar to investment management, custodianship of the Plan assets should be independent and be seen by all stakeholders to be independent from government. It also must be protected from the claims of Plan members and other third party creditors. Canada's banks, credit unions, trust companies and perhaps insurance companies are well positioned to act as custodians of some or all of the ABC Plan assets. Again, details of the custodianship and structure of the fund holding the ABC Plan assets are matters that should be determined by the Steering Committee when making its recommendations on Plan structure and design.

Communication of ABC Plan to members and employers

One of the most significant challenges facing the implementation and success of an ABC Plan will be the communication of its purposes and rationale as well as the ongoing communication to participants of the benefits of joining and maintaining membership in the Plan. Similar to any communication of benefit plans to employees, an ABC Plan would have to consider how best to communicate with a disparate group of plan members situated across both provinces from large urban centres to small towns and rural locations. Fortunately, technology will allow extensive communication through the internet. Clearly an ABC Plan would require dedicated communication experts as part of the ongoing administration of the Plan, as well as annual member statements.

Another key communication objective would be explaining the operation of the double opt-out mechanism, so that employers and employees understand the benefits of participation and do not perceive it as akin to "negative billing."

Interactive communications between the Plan administrator and members will be a crucial aspect of the Plan's success and perceived value by employers and employees alike.

11.2 Suggested ABC Plan design

It is contemplated that the ABC Plan would be based on a simple DC formula with, generally, matching employer and employee contribution rates. In essence, the ABC Plan design should provide the benefits to employers of DC cost certainty but include DB-like management and potentially, results, including best-in-class professional management, scale, investment expertise and very strong governance.

The Panel considered and rejected plan designs that had a target benefit or DB plan structure due primarily to the complexity involved in administering such a plan and the potential liabilities that might be associated with trying to deliver a promised benefit.

Government involvement or guarantees are NOT recommended nor, in the Panel's opinion, required. On the contrary, other than assistance in helping launch the Plan, government would have no involvement in or liability for any operational aspects of the Plan.

The design of an ABC Plan should be kept as simple as possible under all circumstances so as to avoid confusion and administrative complexity as well as contribution errors that could occur in any multi-employer DC plan.

Contributions

The ABC Plan design could include a contribution formula that is based on a tier system. In other words, there would be an entry level minimum contribution formula for employers and employees, such as three percent of earnings from both employer and employee. This entry level participation rate might be called the Tier A contribution formula with Tier B and Tier C contribution formulas of six and six percent and nine and nine percent respectively. In this way, some employers could participate in Tier A, Tier B or Tier C of the ABC Plan based on their particular circumstances.

The plan could also be designed to accommodate employers who wish to participate on a non-contributory (fully employer-paid) basis. Likewise, if the employer opted out, employees who did not opt out would participate as the sole contributor.

The key recommendation here is that there should be flexibility to allow increased contribution rates above a minimum, including allowing employees to make additional voluntary contributions. This design feature would increase administrative complexity but would add flexibility and encourage increased savings. The challenge with any multi-contribution formula is to ensure that the administration of these multiple contributions can be managed by the plan administrator efficiently with little or no room for payroll contribution errors.[77]

Portability and locking in

We also recommend that a member's account balance in the ABC Plan be transferable from the plan only if a period of time has elapsed since the member has been employed by a participating employer, similar to most existing multi-employer plans. We recommend that the Steering Committee consider what rules should apply, keeping in mind that multiple transactions would drive up costs. In any event, the members could leave their entitlements in the plan as deferred members or, if they remain a resident of one of the two provinces, continue to participate individually. Self-employed people could transfer their account balances at any time.

The ABC Plan would have great advantages for employees (and employers) in terms of facilitating worker mobility. Unlike individual employer sponsored pension plans that require paperwork upon termination of employment regarding pension entitlements, an

[77] Keith Ambachtsheer recommends in his "Canada Supplementary Pension Plan" ("CSPP") paper a goal to replace 60 percent of earnings, including CPP and OAS. To accomplish this, Mr. Ambachtsheer recommends automatic deductions would be made on earnings between a floor of approximately $30,000 (representing the likely amount covered by the CPP and OAS) below which no automatic CSPP contributions would be made and a ceiling of approximately $111,000.00 (the current maximum deferral ceiling). He suggests an automatic contribution could be set at 10 percent of earnings. However, the Panel is not of the view that a contribution formula of 5 and 5 percent of earnings is necessary. Contribution levels should be flexible enough to accommodate any contribution structure acceptable under the *Income Tax Act* and would be more widely accepted by participants.

ABC Plan would not require transfers of members' individual accounts as they change from one employer to the next.

Funds transferred out would be locked-in under the locking-in rules applicable to any registered pension plan in our provinces – that is, they would have to be transferred to a locked-in vehicle and used only to provide pensions unless the standard locking-in exceptions applied – e.g. financial hardship, terminal illness, small amounts, or non-residency in Canada. We strongly advocate that this plan be designed based on the option we have recommended in Section 9.1 that would allow a plan to prevent unlocking in other circumstances.

Vesting

Vesting of employer contributions should be immediate in order to simplify administration of the Plan and to avoid pension adjustment reversals and refunds of unvested employer contributions.

However, the Steering Committee should consider a waiting period before new employees are subject to auto-enrolment. Such a waiting period may make participation more attractive for employers, especially those with a high percentage of temporary or seasonal workers, and would recognize the standard practice of probationary periods.

11.3 Implementing an ABC plan

Clearly the terms, conditions and design features of an ABC Plan would require considerable study as would the details of how a cross-provincial multi-employer pension plan would be administered and regulated.

As mentioned above, the Panel recommends that a Steering Committee be appointed jointly by our governments made up of experts in pension plan administration, governance and investment to make specific recommendations on how best to design an ABC Plan in a manner that would ensure its successful launch and acceptance by employers and employees in our provinces.

The Steering Committee should have a mandate not only to make specific plan design recommendations, but also to suggest the means by which key participants in an ABC Plan operation would come to the table. The Steering Committee would also seek input from stakeholders from within the pension delivery system generally. The Steering Committee's consultative role will be extremely important to understand the concerns and suggestions of stakeholders as well as to achieve their crucial buy-in to the ABC Plan's purposes and objectives.

The Panel recommends that immediate steps be taken by our governments to examine the feasibility of establishing the ABC Plan and, assuming this feasibility study yields positive results, take action in implementing this Plan along the lines of the design discussed above.

The Panel recommends that:

11-A The governments should establish a Steering Committee made up of experts in pension plan administration, governance and investment to examine the feasibility of establishing a multi-employer pension plan available to all employers and employees working in our provinces. The Steering Committee should have a mandate not only to make specific plan design recommendations but also to suggest the means by which key participants (especially employers and employees) in the ABC Plan operation would work together to ensure their buy-in to the ABC Plan's purposes and objectives. We also encourage the Steering Committee to consult with other provinces who may be considering similar plans.

11-B The ABC Plan design should be based on a simple DC formula with, generally, matching employer and employee contribution rates. Although the Panel recommends an entry level participation rate of a minimum of three percent of employee's earnings, the Plan design should be flexible enough to allow both employers and employees to make contributions without matching contributions from each other in order to encourage increased savings by all ABC Plan participants.

11-C All employers and workers, including self-employed individuals earning employment or self-employment income in either Alberta or British Columbia, should be eligible to participate in the Plan. All employers and employees should be automatically enrolled in the ABC Plan but the employer and/or their employees should be allowed to opt out of participation if they so choose. Employees whose employer has opted out should still be automatically enrolled without employer contributions unless they choose to opt out. Self-employed individuals in our provinces should also be encouraged to participate in the Plan. Auto-enrolment is not recommended – rather, participation by self-employed individuals should be on an opt-in basis.

11-D The Steering Committee should explore options to create incentives for employers who do not already provide a pension plan not to opt-out of participation in the ABC Plan.

11-E Eligibility for membership in the Plan could be based on a minimum earnings threshold. Membership would be available to anyone between the ages of 18 and 71.

11-F Governance of the ABC Plan should be at arm's length from government. There are several models of pension governance that the governments could consider.

11-G **The majority of the board of governors should be experts in the pension industry, and the rest should represent employer and employee groups to give the governance the transparency and depth necessary to properly manage the ABC Plan. Trustee qualifications should be strictly enforced to ensure that all trustees have the appropriate expertise to fulfill their responsibilities (See Section 7.1.1 "Trustee/fiduciary education" above).**

11-H **Administration of the Plan should be at arm's length from government. The board of governors would ultimately be responsible for deciding how best to structure the administration of the Plan.**

11-I **The Panel does not recommend that employers or employees contributing to the ABC Plan have any investment choice. Rather, the Panel recommends investment of the Plan assets would be subject to the policy direction of the board of governors.**

11-J **The Plan's design could include auto-annuitization, spreading out annuity purchases over time to minimize longevity risk and retirement end-date sensitivities which would help mitigate risks of market volatility.**

11-K **Custodianship of the Plan assets must also be independent from government. Current well-established financial institutions are well positioned to act as custodians of some or all of the ABC Plan assets, and should be considered as key players in the ABC Plan structure.**

11-L **Contributions to the ABC Plan should be locked in similar to the locking-in rules applicable to any registered pension plan in our provinces.**

11-M **Vesting of employer contributions to the ABC Plan should be immediate.**

12.0 Next Steps

In this report, the Panel has made recommendations for a comprehensive overhaul of pension standards legislation in Alberta and British Columbia and on a variety of related topics that are inextricably related to the health and viability of the pension system in our provinces and across the country. Appendix D contains a consolidated list of the recommendations that appear throughout this document. If, as we hope, the governments decide to proceed with the recommended changes to modernize pension standards legislation in Alberta and British Columbia and to establish the ABC Plan, there is clearly much work to be done. However, the need is great, and we strongly urge the governments to proceed together on implementing these recommendations as soon as possible.

Our recommendations for change contain a number of practical steps that can be taken by the governments to move the implementation process forward over the short, medium and longer terms, including:

- developing a communication program around the proposed changes to obtain input from interested and affected stakeholders;
- entering into discussions with the federal government regarding our suggested tax and bankruptcy law changes;
- entering into discussions with the CIA to obtain necessary input surrounding the details for our proposed funding rules;
- entering into discussions with the CICA regarding the impact of the IFRS rules on pension plans and their sponsors, and consideration of alternatives;
- entering into discussions with the education ministries in both provinces regarding the development of financial literacy education programs and trustee accreditation programs;
- appointing an initial JPAC to advise the governments and assist in the development of new legislation;
- appointing a joint committee of officials from the two governments to take the recommendations in this report from concepts to new legislation;
- appointing the Steering Committee to develop the governance structure and design of the ABC Plan; and
- taking a leadership position on pension issues in Canada by spearheading a national council of ministers responsible for pensions to discuss the recommendations contained in this report and those in Nova Scotia, Ontario and elsewhere, and national reform of the pension system generally.

The task given to the Panel by the governments has proven, not surprisingly, to be an extraordinarily challenging one. However, the members of the Panel and the many stakeholders who participated in our review process took on that challenge in the interests of all Albertans and British Columbians. It is now up to the governments to take action in order to bring about positive change and ensure the viability, health and growth of the pension system in Alberta and British Columbia.

Appendix A

The following is a list of the groups that participated in the consultations, either through in-person meetings or written submissions.

Air Canada Pionairs

Alberta Employment Pension Plan Administration Advisory Committee (EPPAAC)

Alberta Federation of Labour

Alberta Financial Hardship Unlocking Program

Alberta Investment Management Corporation (AIMCo)

Alberta Ironworkers Pension Fund

Alberta Refrigeration Industry Pension Trust Fund

Ambachtsheer, Keith

AON Consulting

Association of Canadian Financial Corporations (ACFC)

Association of Canadian Pension Management (ACPM-ACARR)

Banish, Robert W.

Beauregard, Gerard

Bell Pensioners' Group Inc.

Bennett Jones LLP

Blakes (Blake, Cassels & Graydon LLP)

Bliskis, Paul

Boilermakers' Lodge 146

Boilermakers' Lodge 359 Benefit Plans

Boilermakers' Lodge 359 Pension Board

Boilermakers' Lodge 359 Pension Plan

Bricklayers and Allied Craftworkers Pension Fund of Alberta and Saskatchewan

Brown, Allen

B.C. College Pension Board of Trustees

B.C. Federation of Labour

B.C. Hydro

B.C. Investment Management Corporation

B.C. Labourers' Pension Plan Board of Trustees

B.C. Pension Corporation

B.C. Public Service Pension Board of Trustees

Appendix A (continued)

B.C. Pulp and Paper Industry Pension Plan

B.C. Teachers' Federation

B.C. Teachers' Pension Board of Trustees

Buck Consultants, an AEC Company

Burkosky, Rod

Calgary District Pipe Trades Pension Plan Board of Trustees

Calgary Millwrights Pension Plan Board of Trustees

Canadian Federation of Independent Business

Canadian Federation of Pensioners

Canadian Institute of Actuaries

Canadian Life and Health Insurance Association

Canadian Office & Professional Employees Union (COPE)

Canadian Union of Public Employees (CUPE) – CUPE B.C. and CUPE Alberta

Canadian Western Trust

CARP, Canada's Association for the Fifty-Plus

C.D. Howe Institute

Cement Masons' Pension/Welfare Trust Funds

Christian and Missionary Alliance in Canada (The)

College and Association of Registered Nurses of Alberta

Common Front for Retirement Security (CFRS)

Communications, Energy and Paperworkers Union of Canada

Conroy, Al

Cooper, Don

Co-operative Superannuation Society (CSS) Pension Plan

Crawley,Terry

Davis LLP, Pension and Benefits Group

Dimery, Len – Boilermaker

Edmonton Pipe Industry (The)

Electrical Industry Pension Trust Fund of Alberta (EIPTFA)

Elk Valley Coal Corporation

Ellsworth, Carl

Federal Superannuates National Association (FSNA)

Appendix A (continued)

Federation of Alberta Gas Co-ops

Franta, Darryl

Gamache, Charles

Gendron, Denis

Griffin, Mike

Hermary, Richard

Hewitt Associates

Interior Lumbermen's Pension Plan

International Association of Bridge, Structural, Ornamental and Reinforcing Iron Workers

IUPAT Local 177 Pension Trust Fund

Jobi, Colin

Laborers' Pension Fund of Western Canada

Lawson Lundell LLP

Le Comte, Gary

Leitch, Dan

Leith Wheeler Investment Counsel Ltd.

Leong & Associates, Actuaries and Consultants Inc.

Makarchuk, Dave

Medcke, Richard

Mercer Canada Limited

Morneau Sobeco

Multi-Employer Benefit Council of Canada (MEBCO)

Neville, Ian

Olson, F.H.

Operating Engineers Local 955 Trust Funds

Osler, Hoskin & Harcourt LLP

Paterson, Jim

PBI Actuarial Consultants Ltd.

Peacey, John

Pension Investment Association of Canada

Phillips, Hager & North Investment Management Ltd.

PNG Pension Plan Board of Trustees

Appendix A (continued)

Prendergast, Albert M.

Price, Clint

Provencher, Robert J.

Pulp, Paper and Woodworkers of Canada

Satanove & Flood Consulting Ltd.

Shareholder Association for Research and Education

Sheet Metal Workers International Association, Local 276

Shell Canada Limited

Smith, Mitchell A.

Standard Life Assurance Company of Canada

Strategic Income Security Services

Talisman Energy Inc.

TD Asset Management Inc.

Teamsters Local 213 Pension Plan Board of Trustees

Teamsters National Pension Plan Board of Trustees

Towers Perrin

Townley, D.A. & Associates

TransAlta Corporation

University of British Columbia Faculty Pension Plan

University of Victoria Staff Pension Plan

United Association of Journeymen and Apprentices of Plumbers and Pipe Fitters

United Food and Commercial Workers Union Pension Plan

United Steelworkers District 3, Western Provinces / Territories

USW/IWA Wood Council Pension Plan for Elected Officers and Appointed Staff

Victoria-Vancouver Island Newspaper Guild

Vinoly, James

Watson Wyatt Worldwide

Watton, Helen

Westcoast Actuaries Inc.

Williamson, Donald

Wong, Rita

Appendix B
Alternate Plan Structures

	DB or DC	Regulation	Governance	Eligibility	Risk	Contributions	Benefits	Investments
Superannuation (Australia)	DC	Federal government, through tax and financial institution regulatory bodies	Co-op: A Board of trustees is responsible for strategy, goal setting and monitoring; a CEO reports to the Board and is responsible for day-to-day operations; investment decisions are contracted to external managers (per Sunsuper)	Mandatory for everyone between ages 18 and 70 and earning over $450/month	Employers have no risk; employees pool risk unless they choose the self-directed option	Employers must contribute a minimum of 9% of employee earnings; employees may make substantial additional contributions; government contributes $1.50 (up to a total $1,500) for every dollar contributed by low income employees; withdrawals based on employee tax-paid contributions are tax free	On retirement, members either buy an income stream from the plan or an annuity from an insurance company; can be accessed at 55 (rising to 60 by 2024)	Employees have a choice of pooled investment super funds or a self-directed option; investment and participant education program built around 3 investment options (low, medium and higher risk); fund earnings are taxed at a lower rate
KiwiSaver (New Zealand)	DC	Predominantly through the tax office and Government Actuary	Trustee oversees and is legally responsible for administration of scheme; trustee delegates administration and investment management to a manager	Every citizen or permanent resident between the ages of 18 and 65 is automatically enrolled, with the ability to opt out	Employers have no risk; employees pool risk	Employers must contribute 1% of employee's earnings rising to 4% by April 2011; participating employees may choose to have either 4% or 8% of their earnings deducted and contributed and may personally contribute additional amounts; contributions are deducted from employee's gross earnings	Savings withdrawn as lump-sum at 65 or after five years' membership, whichever is later; withdrawals are tax free	Employees have a choice of authorized Kiwisaver investment scheme providers with a range of funds to invest in; investment fund earnings are attributed to employee and are taxable
Personal Accounts (United Kingdom)	DC	Government will establish a personal accounts board	Not yet established	Everyone earning over £5,000/year and between 22 and State Pension age is automatically enrolled with ability to opt out	Employers have no risk; employees pool risk	Employers contribute 3%; government provides 1% tax break; employees contribute 4%	At age 55, account owner may unlock up to 25%, and by age 75 must purchase an annuity, either from the plan or an insurance company, can be life or fixed	Default fund offered, limited choice of funds to invest in
Employees Provident Fund (Malaysia)	DC	Regulated by the government through the *Employees Provident Fund Act 1991*	Board of Directors and Investment Panel	Every worker and employer must participate	Employers have no risk; employees pool risk	Employers contribute 12%; employees contribute 11% of earnings; either may contribute more	At age 55, members may withdraw a lump-sum or start monthly payments, or do both; members may also withdraw to buy a house or fund education	Most funds invested on behalf of members, members may invest small amounts

Appendix B (continued)
Alternate Plan Structures

	DB or DC	Regulation	Governance	Eligibility	Risk	Contributions	Benefits	Investments
TIAA-CREF (United States)	DC	Federal government through the *Employee Retirement Income Security Act* (ERISA)	Two legally separate companies managed by two Boards of Overseers and two Boards of Trustees - TIAA is a stock life insurance company - CREF is a nonprofit organization that provides retirement annuities	Employees of eligible organizations (colleges, universities, schools, medical, education, research and other non-profit institutions.)	Employers have no risk; employees pool risk; TIAA bears longevity risk post-retirement	Set by employers; limited by Internal Revenue Code ($46,000 for employers; $15,500 for employees)	Annuities or a lump-sum withdrawal, withdrawals prior to age 59 ½ subject to 10 percent penalty tax per IRA rules	Employers select funds available to employees, who select which to invest in
UBC Staff Plan	Target Benefit	BC Superintendent of Pensions	Management is delegated to a pension board (not jointly trusteed) – 4 employer directors and 4 member directors	UBC staff	No risk to employer – members pool risk – plan funding shortfalls result in benefit cuts. The plan has negotiated with CRA that a contingency reserve of up to 40% of liabilities can be included in the actuarial valuation as a liability – and does not contravene the 10% surplus rule.	Contributions are fixed by contractual terms of plan text. Since inception, employer has contributed 8.2% of salary <YMPE and 10% of salary>YMPE. Members contribute 3.2% of salary<YMPE and 5% of salary>YMPE	Typical 2% of Final Average Salary with .7% CPP offset	No information
Proposed Canada Supplementary Pension Plan	DC	Would be regulated by existing pension regulators	An arms-length expert entity similar to the CPP Investment Board	All Canadian workers not covered by another workplace pension plan would be automatically enrolled with employers and employees having the ability to opt out	Employers have no risk; employees pool risk	Suggested default employer and employee contribution rates are 5% each on earnings between $30,000 and $111,111	Could purchase annuity or transfer funds to RRIF-type investment plan	Two portfolios - one medium risk (for most members), the other low (for members near retirement)
Simplified Pension Plan (Quebec)	DC	Regulated by the Regie des Rentes du Quebec, subject to the Supplemental Pension Plans Act	Administered by financial institutions; plans with at least 50 members may choose to establish a members' information committee	May include all employees of business or just category of employees	Employers have no risk; employees pool risk	Contributions determined by plan design; employers must contribute and those contributions are locked-in; employees may be required to contribute and those contributions may or may not be locked-in	At age 55 members may either purchase a life annuity or transfer locked-in funds to a LIF; unlocked funds may be transferred to employee at any time	Financial institutions must offer at least three options with different levels of risk

Appendix B (continued)
Alternate Plan Structures

	DB or DC	Regulation	Governance	Eligibility	Risk	Contributions	Benefits	Investments
Member Funded Pension Plan (Quebec)	DB	Regulated by the Regie des Rentes du Quebec, subject to the Supplemental Pension Plans Act (SPPA) and the Regulation respecting the exemption of certain categories of pension plans from the application of provisions of the SPPA	If more than 25 members in the plan, there must be a pension committee; specifics set out in plan text	Unionized employees only unless otherwise permitted by the Canada Revenue Agency	Employers have no risk; employees share risk of delivering the DB promise (funding shortfalls are met by increased member contributions)	Employers make only negotiated fixed contributions; employees must make contributions that are sufficient to deliver the defined benefit promise; employees may also make additional voluntary contributions that are kept in a separate employee account	Defined benefit monthly payments, no lump-sum payments	Investment decisions and policy made by pension committee
Co-operative Superannuation Society Pension Plan	DC	Regulated by existing the Saskatchewan Superintendent of Pensions	30 delegates (15 employer, 15 employee) are responsible for bylaws, rules and regulations and electing a Board of Directors which sets investment policy and hiring manager of day-to-day operations	Requirement for all full-time employees of member cooperative association and credit union employers	Employers have no risk; employees pool risk	Each participating employer sets the contribution rate from 1 to 9%; employers and employees make equal contributions	Can purchase annuity or transfer to LIF, normally at 60, with early retirement at 50	Two portfolios - one medium risk (for most members), the other low (for members near retirement or risk-averse members)
Saskatchewan Pension Plan	DC	The Saskatchewan Minister of Finance is responsible for its operation	A Board of Trustees is responsible for overall administration of the plan and investment policy; investments are delegated to fund managers	Open to anyone between ages 18 and 71 (not an occupational pension plan)	Employer participation is entirely optional; plan members share investment risk	Contributions are limited to $600/year per plan member; employers or individuals, or both, may contribute	Funds are locked-in until age 55, at which time the member may purchase an annuity, transfer funds to a LIRA, or unlock accounts that would deliver only a small pension	Two portfolios - one medium risk (for most members), the other low (for retired members)
Universities Academic Pension Plan	DB	Alberta Superintendent of Pensions	Plan Sponsors (from boards of governors and faculty associations of member institutions) responsible for any plan changes and appointing Board of Trustees responsible for administration, investment and setting contribution rates	Must be academic or professional staff from participating institution	Shared by employers and employees	Employees contribute 8.27 percent up to YMPE and 11.21 percent above; matched by employer	DB plan, based on highest five consecutive years earning	Single portfolio managed by Board of Trustees

Appendix C
Irritants and Harmonization Issues

Issue	Alberta			British Columbia			CAPSA Position	Comments / Recommendation
Filings								
Deadlines for filing of actuarial valuations	EPPR	10(2)	Within 180 days of valuation date for triennial reviews.	PBSR	7(2), (5)	Within 270 days of valuation date for triennial reviews and within 120 days for new plans.	Triennial valuations or those requested by the Superintendent should be filed within 9 months of the date of the actuarial review of the plan.	The general rule (Manitoba, New Brunswick, Ontario, Quebec and Saskatchewan) is 270 days from the valuation date (9 months). Valuations must be filed within 1 year in Nova Scotia and within 6 months for federally regulated plans. Recommendation: BC - 270 days
Requirement to file audited financial statements	EPPR	11(2), (3)	Requirement to file audited financial statements for SMEPPs, DB plans with assets >$3 million and DC plans with assets >$1 million.	PBSR	4(4), (5)	Financial statements are not required to be audited or filed with regulator unless the value of plan assets exceeds $10 million.		Recommendation: BC approach with Superintendent discretion to request statements at any time
Funding Standards								
Terminology re surplus	EPPA	1(1)	Going concern surplus = "excess assets"; solvency surplus = "surplus assets"	PBSR	1(1)	"Surplus assets" means excess of assets over liabilities - no distinction for going-concern v solvency		Recommendation: Alberta approach
Application of actuarial gains	EPPR	48(9.1), (10), (10.1)	Where a filed actuarial valuation or cost certificate reveals a going concern or solvency actuarial gain, the gain shall be used to amortize or to reduce the outstanding balance of an unfunded liability or solvency deficiency, with the liabilities being amortized or reduced in the order in which they were established. Where a gain is used to reduce a liability or deficiency, remaining special payments may be reduced on a prorated basis over the period which they are payable.	PBSR	35(7)	If a filed actuarial valuation report reveals that the plan has actuarial gains, the actuarial gains must be used to amortize or, where insufficient to amortize, to reduce the outstanding balance of any unfunded liability, with the oldest established unfunded liabilities being amortized or reduced before later ones.	If a valuation reveals an actuarial gain on the going-concern and/or the solvency position of a pension plan, those gains must be applied to existing unfunded liabilities or solvency deficiencies respectively, starting with the earliest established liability or deficiency, as the case may be. Only after experience gains are realized would an actuary be permitted to advise that either the special payment levels be maintained, thereby effectively reducing the amortization period, or that the special payment be recalculated such that the original amortization period of the remaining liability or deficiency is maintained.	AB allows special payments for both unfunded liabilities and solvency deficiencies to be reduced when an actuarial gain is revealed. This is consistent with the CAPSA position. BC only allows special payments for unfunded liabilities to be reduced, which is inconsistent with the CAPSA position. Recommendation: Alberta and CAPSA approach

Issue	Alberta		British Columbia		CAPSA Position	Comments / Recommendation
Frequency of payments	EPPR 48(3)	Subject to subsection (4) and sections 48.1 and 49(2), an employer shall pay into a plan, (a) in respect of current employment, an amount of employer contributions on at least a monthly basis equal to the normal actuarial cost allocated to the employer, as stated in the most recent actuarial valuation report or cost certificate filed, (b) where the plan has one or more unfunded liabilities, payments consisting of equal payments made at least monthly that are sufficient to amortize the unfunded liability or each unfunded liability over a period not exceeding 15 years from the review date relating to its establishment, and (c) where the plan has one or more solvency deficiencies, payments consisting of equal payments made at least monthly that are sufficient to amortize the solvency deficiency or each solvency deficiency over a period not exceeding 5 years from the review date relating to its establishment.	PBSR 35(3)	Subject to subsection (4), every employer must pay into a plan, (a) in respect of current employment, employer contributions made at least quarterly in an amount that is equal to the normal actuarial cost allocated to the employer as stated in the most recent actuarial valuation report filed, (b) if the plan has an unfunded liability, equal payments made at least quarterly in an amount that is sufficient to amortize the unfunded liability over a period not exceeding 15 years from the review date that established the unfunded liability, and (c) if the plan has a solvency deficiency, equal payments made at least quarterly...	All contributions are to be made monthly	Current service costs and special payments must be made on at least a monthly basis in Alberta versus a quarterly basis in BC. Recommendation: Alberta and CAPSA approach – monthly

Appendix C (continued)
Irritants and Harmonization Issues

Issue	Alberta			British Columbia			CAPSA Position	Comments / Recommendation
Disclosure								
Prior notice of amendment	EPPA EPPR	15(1)(a.1) 13.1(1) 1(9)	Members must be provided with notice not less than 45 days before the effective date of an "adverse amendment." (9) For the purposes of the Act, a person is adversely affected by an amendment to a pension plan if the amendment negatively affects the person's entitlement or potential entitlement to a benefit or increases the cost to the member of securing a benefit.			No requirement to disclose an adverse amendment to members prior to the registration of the amendment.	Administrators must provide notice of an amendment to the pension plan to all members and any collective bargaining agent representing members prior to the effective date of the amendment.	Manitoba, Newfoundland and Saskatchewan's statutes and the federal legislation contain no requirement to disclose adverse amendments to the members before registration. New Brunswick, Nova Scotia and PEI require notice at least 45 days before registration; Ontario also requires notice but it is limited to those person identified by the Superintendent. Quebec requires disclosure of every amendment prior to registration. Recommendation: BC approach - for all types of plans: no requirement to disclose adverse amendments in advance
Other Issues								
Unlocatable beneficiaries	EPPA EPPR	77.1 64.1	The Act and Regulations allow a plan administrator, where an individual with a benefit entitlement in a full plan termination pension plan cannot be located, to commute and transfer the benefit on a non-locked in basis to the Public Trustee's Office in Alberta.			No provisions regarding unlocated beneficiaries.	The principles provide that, where assets remain in a terminated plan which the administrator is unable to distribute to the appropriate beneficiary after making reasonable efforts to do so, the outstanding amount will be referred to a public agency.	Alberta's provisions are consistent with CAPSA approach. Recommendation: CAPSA/ Alberta approach
Early retirement	EPPA	44(5)	Early retirement must be provided 10 years prior to pensionable age as defined by the plan.	PBSA	38(6)	Early retirement must be provided at age 55.	Early retirement must be provided ten years prior to normal retirement age.	Recommendation: Alberta/CAPSA approach: 10 years before normal retirement date as defined by the plan
Phased retirement	EPPR	31(1)	The regulation requires that a member may make contributions or receive benefits, but not both. When read together with s. 27(1) of the EPPA, this is a minimum standard. Alberta allows for phased retirement under these provisions.	PBSA	38(5.1), 38.1	Amendments to the PBSA Spring 08 allow for phased retirement consistent with federal *Income Tax Act* changes, permitting contributions to be made and benefits to be received at the same time	Employers should be permitted to offer phased retirement benefits under the conditions set out in the federal *Income Tax Act.*	Recommendation: BC and CAPSA approach, although may require some amendments to clarify certain aspects

Appendix C (continued)
Irritants and Harmonization Issues

Issue	Alberta		British Columbia		CAPSA Position	Comments / Recommendation
Definition of spouse/pension partner	EPPA 1(1)(ff.1)	“Pension partner” means, in relation to an original owner, (i) a person who, at the relevant time, was married to that original owner and had not been living separate and apart from that original owner for 3 or more consecutive years, or (ii) if there is no such married person, a person, if there is any, who, immediately preceding that time, had lived with that original owner in a conjugal relationship (A) for a continuous period of at least 3 years, or (B) of some permanence, if there is a child of the relationship by birth or adoption, but does not include any person who is not recognized as a spouse or common-law partner for the purposes of any provision of the federal income tax legislation respecting RRSPs.	PBSA 1(1)	"Spouse" means, in relation to another person, (a) a person who at the relevant time was married to that other person, and who, if living separate and apart from that other person at the relevant time, did not live separate and apart from that other person for longer than the 2 year period immediately preceding the relevant time, or (b) if paragraph (a) does not apply, a person who was living and cohabiting with that other person in a marriage-like relationship, including a marriage-like relationship between persons of the same gender, and who had been living and cohabiting in that relationship for a period of at least 2 years immediately preceding the relevant time.	Spouse means, in relation to another person, (a) a person who, at the relevant time, was married to that other person and had not been living separate and apart from that other person; or (b) if there is no person to whom clause (a) applies, a person who has lived with that other person in a conjugal relationship for at least one year.	Alberta's definition includes married couples who have been separated for less than 3 years, versus BC's provision which only captures those separated for less than 2 years. Under Alberta's approach, unmarried couples need to have lived together for at least 3 years, compared to BC's requirement of cohabitation for at least 2 years. Alberta relaxes the 3 year requirement where there is a child by birth or adoption. Recommendation: BC approach
Waiver of pre-pension commencement death benefits	EPPR Form 3 - Pension Partner Waiver of Pre-Pension Commencement Death Benefit under Pension Plan or LIRA	As a requirement of the pre- or post-retirement benefit waiver, a pension partner must certify that they have obtained "independent" advice about the implications of signing this waiver.		No similar requirement in BC	No provision.	Recommendation: BC approach - remove the provision from the EPPR. Ensure that the waiver form itself is sufficiently clear that the spouse understands the implications of signing. Prescribe plain English form that includes a prominent warning that "Signing means that you are giving up rights - if you do not understand this form, please seek advice."

Appendix C (continued)
Irritants and Harmonization Issues

Issue	Alberta			British Columbia			CAPSA Position	Comments / Recommendation
Class Rules	EPPR	30(1)	Prescribed classes of employees: (a) employees paid a salary (b) employees paid on an hourly basis (c) employees who are members of a trade union (d) employees who are not members of a trade union (e) supervisory employees (f) management employees (g) executive employees (h) employees who are officers of employer (i) employees who are significant shareholders (j) persons who fall within (c) or (d) and also (a) or (b), or (e) to (i).	PBSR	23 (1)	Prescribed classes of employees: (a) employees paid a salary (b) employees paid on an hourly basis (c) employees who are members of a trade union (d) employees who are not members of a trade union (e) supervisory employees (f) management employees (g) executive employees (h) employees who are officers of employer (i) employees who are "connected" to employer (as defined in ITA) (j) employees belonging to an identifiable group of employees acceptable to the Superintendent.	A pension plan must identify one or more prescribed classes of employees eligible to be members of the pension plan. If an employee who belongs to a class of employees eligible to be members of the pension plan satisfies the prescribed eligibility criteria, the employee is entitled to become a plan member at the prescribed times. Prescribed classes of employees: similar to Alberta and BC lists plus classes based on geographic location and date of hire.	BC is the only jurisdiction of those that specify classes of members, that prescribes "employees who are connected to the employer (as defined in s.8500(3) of the ITA Regs rather than "significant shareholders". Manitoba, New Brunswick, PEI, Quebec and federal legislation do not prescribe classes of members. Recommendation: CAPSA without prescribed classes. Allow plans to define classes for eligibility – but not based on person characteristics
Commuted value - age restriction	EPPA	38(1)	Plan may restrict commuted value transfer "10 years before the member's attaining pensionable age"	PBSA	33(1.1)	Permitted restriction on the ability to transfer a commuted value if the member has reached the age of 55.	Restriction permitted within 10 years of normal retirement date.	Recommendation: Alberta/CAPSA approach – 10 years before normal retirement date (and define normal retirement date)
Vesting	EPPA	31(1), (2), (3)	For years of membership before January 1, 1987, the "45 & 10" rule applies (i.e. vesting crystallizes when the employee attains age 45 and has at least 10 years of continuous employment). For years of membership on and after January 1, 1987 but before January 1, 2000, vesting crystallizes after 5 years of continuous employment. For years of membership after January 1, 2000, vesting crystallizes after 2 years of continuous employment.	PBSA	26(1)	Immediate vesting on termination if member has completed 2 years of continuous membership. No grandfathering provisions with respect to vesting.	The principles propose that all pension benefits be vested immediately for all plan members' service.	Feedback: Immediate vesting would be very costly for multiemployer negotiated cost plans Recommendation: BC approach. Eliminate AB grandfathering provisions
Portability - deadline for offering options	EPPA EPPR	15(1)(c) 15(1)	Within 60 days of termination date or receipt of written request respecting termination.	PBSA PBSR	10(1)(c) 12	Within 90 days of termination date.	Within 60 days of termination date.	Recommendation: BC approach - more time is better

Appendix C (continued)
Irritants and Harmonization Issues

Issue	Alberta			British Columbia			CAPSA Position	Comments / Recommendation
Payment of wind-up expenses from plan fund	EPPA	79	The Superintendent may permit reasonable expenses related to the plan wind-up to be paid out of the plan.	PBSA	57(1), (2), (3)	The Superintendent may permit reasonable wind-up expenses to be paid out of the plan unless the sponsoring employer (except MEPPs and single-employer NC plans) continues or intends to continue in operation.	Assets of the plan may be used to pay termination expenses if the plan so provides or if the consent of the regulatory authority is obtained.	Recommendation: CAPSA approach except rather than "if plan so provides", it should be "if plan does not explicitly prohibit"
Retention of records	EPPA	16(1)	An administrator or a non-administrator employer shall retain records relating to a pension plan for a period of at least 3 years after (a) in the case of records affecting a person who received a benefit, the date when the benefit (i) ceased to be paid, in the case of a continuing benefit, or was paid, in any other case, or (ii) was previously insured through an insurance company, and (b) in the case of other records, the date when they ceased to be operative or until such later date as they cease to be required in order to comply with section 15(4).	PBSA	11	An administrator, or any other person responsible for the administration of a pension plan, who has possession or custody of any record respecting the plan must retain the record as follows: (a) in the case of a record relating to a person entitled to benefits under the pension plan, for at least 6 years after the date all rights or entitlements of the person under the pension plan were paid, settled or extinguished; (b) in the case of a document that creates or supports the pension plan, or any previously created document, for at least 6 years after the later of (i) the date on which the last assets of the pension fund were distributed, and (ii) the date on which the winding up of the pension plan is approved by the regulatory authority responsible for pensions; (c) in the case of a record not described in paragraph (a) or (b), for at least 6 years after the date of the last transaction to which the record relates.	7(1) Records respecting a pension plan which are in the possession or custody of the administrator, employer or any other person (other than the plan member) shall be retained for the longer of (a) the period within which a member or former member may exercise rights under limitations legislation in the jurisdiction of employment , and (b) a period of at least in the case of a record relating to a person entitled to benefits under the pension plan 7 years after the date all rights or entitlements of the person under the pension plan are paid, settled or extinguished; in the case of any document that creates or supports the pension plan or any predecessor pension plan - 7 years after the later of; i) the date upon which the last assets of the pension fund are distributed, and ii) the date upon which the wind up of the pension plan is approved by the regulatory authority; and in the case of any other record, 7 years after the later of the date of the last transaction to which the record relates or the date when the record ceases to be operative.	Recommendation: CAPSA approach

Appendix C (continued)
Irritants and Harmonization Issues

Issue	Alberta		British Columbia		CAPSA Position	Comments / Recommendation
Cessation and suspension of membership	EPPA 30	(1) A member of a pension plan is not entitled to cease to be a member except on termination of membership. (2) A pension plan may provide that a member may suspend membership in the plan while continuing to do work or provide a service in an employment covered by the plan. (3) Where a pension plan allows a member to suspend membership, (a) it may also provide that there will be no further accrual of benefits during the suspension, and (b) it must also provide that the suspended member has the right to lift the suspension at any of the times prescribed. (4) Subject to subsection (5), where a person's membership in a plan is suspended, the suspended member is not entitled to receive or transfer any benefits from the plan until the termination of membership or of the plan. (5) A plan may provide that a suspended member who would be entitled to receive a pension if the suspended member were terminating membership may elect to transfer its commuted value to a locked in retirement account in accordance with the conditions specified in and prescribed in relation to section 38(1) and (2) if that commuted value exceeds the amount prescribed in relation to commuted value for the purposes of section 46(1), as if the suspended member were a former member.		No equivalent provision.	No provision.	Recommendation: Alberta - provides more flexibility

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Irritants and Harmonization Issues

Issue	Alberta			British Columbia		CAPSA Position	Comments / Recommendation
Vesting on termination of plan	EPPA	33	On the termination of a pension plan, there immediately and unconditionally vests in each member an entitlement to receive a pension in respect of the member's membership on and after the initial qualification date.	PBSA	28	On the termination of a pension plan, there immediately vests in each member an entitlement to receive a pension in respect of his or her membership in the plan.	For the purposes of the Act and Regulations, a benefit vests in a member when the member acquires an unconditional entitlement under the terms of the pension plan to receive the benefit, immediately or at a future date. Immediate vesting of pension benefits shall be applied retroactively for all active members' service.	Recommendation: CAPSA approach
Ancilliary Benefits	EPPA	42	(1) A pension plan may provide, as an ancillary benefit, any of the following benefits: (a) disability benefits; (b) bridging benefits; (c) to the extent that they exceed the minimum requirements of this Part, (i) pre-retirement death benefits, (ii) early retirement benefits, and (iii) postponed retirement benefits, being enhancements to the pension of a person referred to in section 44(2) beyond that payable as a result of the application of that subsection; (d) other benefits that are prescribed to be ancillary benefits. (2) When and only when a member or former member meets all the eligibility requirements under the plan necessary to exercise the right to receive the ancillary benefit, that benefit becomes part of the member's or former member's overall benefit entitlement. (3) Subsection (2) does not apply to optional ancillary benefits.			No equivalent provision.	A pension plan may provide the following ancillary benefits: disability benefits; bridging benefits; supplementary benefits, other than bridging benefits, payable for a temporary period of time; pre-retirement death benefits in excess of those required by the Act or regs; early retirement benefits in excess of those required by the Act or regs; joint and survivor pension benefits in excess of those required by the Act or regs; postponed retirement benefits in excess of those required by the Act or regs; and any prescribed ancillary benefit. An ancillary benefit to which a member has become fully entitled by meeting all the eligibility requirements under the plan shall be included in the calculation of the member's benefit.	Recommendation: CAPSA approach

Issue	Alberta			British Columbia			CAPSA Position	Comments / Recommendation
Notification of Termination or Winding-Up	EPPA	72	An administrator who intends to terminate or to wind up a pension plan shall notify the Superintendent in writing of that intention	PBSA	50(1)	An administrator who intends to terminate or wind up a pension plan must give notice of the intention to terminate or wind up, in writing, to the following: (a) the superintendent; (b) each member and former member; (c) each union whose members will be affected; (d) if a member or former member has died, the surviving spouse, designated beneficiary or personal representative of the estate of the member or former member as ascertainable by the administrator.	No provision.	**Recommendation:** Study BC approach for both provinces, but consider whether it should be supported by a prohibition on any further member elections.

Appendix D

Summary of Recommendations

6.0 Objectives and Regulatory Framework

6.1 Objectives of the legislation

6.1-A The governments should commence a comprehensive re-write of the EPPA and the PBSA based on the recommendations contained in this report.

6.1-B The governments should acknowledge as a matter of public policy that the retirement income system is based upon the "three pillars", and should have as a stated policy objective the expansion of "second pillar" coverage in Alberta and British Columbia through the establishment and maintenance of occupational pension plans.

6.1-C The governments, together and in consultation with the federal government, should consider the provision of additional incentives to existing and potential plan sponsors and employers, beyond deductibility of contributions and deferral of tax on investment earnings and benefits, to encourage the establishment and maintenance of pension plans and greater pension plan coverage.

6.1-D The legislation should have the following primary objectives:

- facilitating coverage by reducing barriers causing sponsors to be unwilling or unable to establish or maintain occupational pension plans
- setting streamlined minimum pension standards with effective enforcement powers, while providing maximum flexibility, simplicity and clarity to facilitate the establishment and maintenance of plans
- avoiding over-regulation that could deter employers from participating in the occupational pension system
- ensuring that pension promises made in this new context are kept

6.1-E The objectives of the legislation should be clearly stated at the time it is brought before the legislature. However, the legislation itself should not contain explicit statements regarding objectives, and the provisions of the legislation should stand on their own. Those provisions should be properly designed so as to achieve the objectives referred to in Recommendation 6.1-B and 6.1-D.

6.1-F Pension standards legislation should address all currently foreseeable matters relating to pensions, including those that have been considered by the courts

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to date, in order to incorporate those matters into a comprehensive legislative framework to the extent possible.

6.1-G Where professional standards are to become legislative requirements, they should be specifically identified, and changes should be adopted only if reviewed and agreed to by the governments.

6.2 Principles-based vs. rules-based legislation

6.2-A Pension standards legislation in Alberta and British Columbia should be reconstructed to adopt an approach employing principles wherever possible, supported by detailed rules where necessary. Elements of this approach include:

- principles setting certain criteria of general application, regardless of plan type;
- rules-based standards in some specific areas; and
- different rules applicable to different types of plans, as appropriate. (See also Section 6.3 "Alternative plan designs" below.)

6.2-B Where principles are appropriate, they should be set out in the pension standards statute, supported by more detailed rules that may be subject to more frequent change in the regulations, to ensure that sponsors can manage plans in a manner that provides some confidence as to their obligations.

6.2-C Regulatory policies and guidelines should be developed to provide guidance to plan sponsors, administrators and members on compliance with principles-based standards.

6.2-D The regulator should have the discretion and resources necessary to properly fulfill its role in the context of a principles-based system. (See also Section 6.4, "Role of the regulator" below.)

6.2-E In light of the recommended increase in the discretion of the regulator in a more principles-based system, an adjudicative body should be established to hear appeals from the exercise of that discretion, acting as a "check and balance" within the regulatory system. (See also Section 6.4, "Role of the regulator" and Section 6.5, "Harmonization" below.)

6.2-F Future refinement of the principles in the legislation and the regulatory interpretation thereof should be developed in consultation with an appropriate pension policy advisory body. (See also Section 6.4, "Role of the regulator" and Section 6.5, "Harmonization" below.)

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6.2-G To maintain consistency of interpretation of harmonized legislation, regulatory guidelines should be developed in consultation with the recommended pension policy advisory body and based on agreement between the regulators in each of Alberta and British Columbia. (See also Section 6.4, "Role of the regulator" and Section 6.5, "Harmonization" below.)

6.3 Alternative plan designs

6.3-A The legislation should contain principles of general application to all pension plans, including, without limitation, principles dealing with eligibility to participate, vesting of entitlements, locking-in of benefits, portability of benefits, segregation of assets, the role and identity of the governing fiduciary and how the "pension deal" is to be defined.

6.3-B Different rules should be developed that are appropriate to different existing and future plan types, and such rules should be housed in regulation and/or regulatory policy.

6.3-C The next generation of pension standards legislation in Alberta and British Columbia should be designed to permit flexibility in the development of new plan design types, subject to adherence to the principles of general application.

6.3-D New plan types should be permitted and registrable under pension standards legislation.

6.3-E Employer contributions should not be a necessary element of a registered pension plan. RRSPs, however, should continue to be exempt from pension standards legislation.

6.3-F The legislation should be designed to permit flexibility in the development of new governance structures, and in particular, to allow for more options as to who can be an administrator of a pension plan. However, the role of governing fiduciary should be restricted to existing permitted entities, not-for-profit entities with sufficient capital or liability insurance or for-profit entities subject to regulation consistent with the objectives of pension standards.

6.4 Role of the regulator

6.4-A The legislation should be clear that the role of the regulator is to administer and enforce compliance with the legislation, and not to actively promote pension coverage.

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6.4-B The regulator's role should focus on risk-based monitoring to encourage and enforce compliance with principles-based standards and prescribed rules.

6.4-C The regulator should be provided with sufficient resources to transition personnel and culture to this new model with appropriate training and education.

6.4-D Regulatory decisions made in a more principles-based system and/or with discretion provided by the legislation should be made with cognizance of the impact of such decisions on pension coverage.

6.4-E The regulator should have discretion under the legislation to consider applications for approval of new plan designs and governance structures applying the principles of general application set out in the legislation and to impose such conditions on registration as may be appropriate in the circumstances and consistent with the principles. (See also Section 6.4.1, "Regulator's tools and checks and balances in the system" below.)

6.4-F The regulator should develop administrative policies and guidelines on a collaborative basis with input from the broader pension community, in order to provide guidance on the interpretation of the principles-based standards contained in the legislation.

6.4-G The governments should establish the position of a "pension advocate," whose role would be to promote the pension system and the expansion of pension coverage in Alberta and British Columbia. (See also Section 6.5.2 "Joint Pension Advisory Council" below.)

6.4.1 Regulator's tools and checks and balances in the system

6.4.1-A The regulator should have the power to impose administrative penalties, subject to the following conditions:

- Penalties should only be imposed with proper advance notification in writing that the penalty is intended to be applied and providing a reasonable opportunity for the matter at issue to be "cured" before the penalty is imposed.
- The penalties could be imposed for failure to:
  - file annual information returns on time;
  - file valuation reports on time;
  - file annual financial statements on time;
  - respond to superintendent requests for information on time;

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- disclose information to members on time; or
- make contributions on time.

- Proceeds of fines should be used to finance the regulatory system and should not be directed to the governments' general revenues.
- The authority to impose penalties should be discretionary depending on the circumstances for significant issues of non-compliance or to encourage appropriate plan management/governance, and not as punishment other than in egregious situations.
- Penalties should be imposed on the party responsible for the matter or action at issue, typically the plan administrator, and should not be charged to or be payable from the plan.
- The imposition of the penalty should be subject to appeal. (See also Section 6.5.1, "Joint Pension Tribunal" below.)

6.4.1-B The regulators should be provided with discretion to approve new plan designs and associated governance structures in the following manner:

- The process for approval of new plan designs should be set out in the legislation.
- The legislation should provide the superintendents with the discretion to make guidelines of general application to plans with certain common design features.
- Where the regulator intends to impose conditions of general application for a new type of plan in connection with specific features that are not contemplated in the legislation, consultation with a policy advisory body (to be established by the governments) should be required. In publishing such guidelines, the regulator should identify the particular elements that make the new model different and justify the creation of the guidelines. (See also Section 6.5.2 "Joint Pension Advisory Council" below.)
- Regulators' decisions on plan approvals should be subject to appeal. (See also Section 6.5.1 "Joint Pension Tribunal" below.)
- The legislation should prescribe considerations or conditions that the regulator must take into account in exercising the decision-making discretion.
- In order to encourage and maintain consistency between the two provinces, consultation between the regulators in Alberta and British Columbia should be mandated as a matter of policy of the two

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governments prior to the issuance of any approval or rejection of a new plan design, or the publication of a guideline of general application. (See also Section 6.5 "Harmonization" and Section 6.5.3 "Joint pension regulator" below.)

6.4.1-C The governments should each establish an independent expert administrative tribunal, preferably on a joint basis, to hear appeals from superintendents' decisions. Such a tribunal should be authorized to hear appeals from any decision of the regulator by a party to the issue at hand. (See also Section 6.5.1 "Joint Pension Tribunal" below.)

6.4.1-D The governments should establish a joint policy advisory council to provide broad input and insight to the ministers responsible for pension standards in the two provinces and to the regulators, in respect of matters of pension policy and compliance on an ongoing basis. (See also Section 6.5.2 "Joint Pension Advisory Council" below.)

6.4.2 Financing the regulatory system

6.4.2-A The pension regulatory system should be funded on the following bases:

- The policy aspects of pension regulation are social policy, with the purpose of reducing future dependence on the public purse, and therefore should be funded by general revenues.
- Direct regulatory activities are related primarily to ensuring that the "pension deal" struck by the parties is delivered, and therefore should be funded by user fees.

6.5 Harmonization

6.5-A The governments work together to fully harmonize pension standards legislation in Alberta and British Columbia, resulting in identical statutes with the same name in the two provinces.

6.5-B It should be made clear that the harmonization effort is not designed to produce lowest common denominator legislation or result in a "race to the bottom", but rather that the most appropriate standard in each instance would be adopted.

6.5-C The rule of "final location" should be confirmed in Alberta's and British Columbia's pension standards legislation to ensure that the laws of the jurisdiction in which a plan member worked last apply to that person's benefits, regardless of where the pension credits were actually earned.

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6.5-D The governments should work together to create joint organizational structures that would foster continued harmonization of pension standards legislation in the two provinces, including a Joint Pensions Tribunal, a Joint Pensions Advisory Council and a joint pension regulator. (See also Sections 6.5.1 through 6.5.3 below.)

6.5-E National harmonization initiatives should be pursued by the governments, starting with the establishment of a national council of ministers responsible for pensions as soon as practicable, to consider:

- the viability of harmonized or uniform pension standards legislation across the country;
- if national harmonization were to occur, the viability of a single national pension regulator;
- promotion of the rule of "final location" across the country; and
- continued work towards the "70 percent solution" through the CAPSA Model Law efforts in respect of "non-controversial issues" in the short term.

6.5.1 Joint Pension Tribunal

6.5.1-A The governments should work together to establish a Joint Pension Tribunal having the following characteristics:

- The JPT should be a statutory body constituted under the statutes in each province, with quasi-judicial status.
- The JPT should be established on the "common member" model.
- The harmonized legislation should include a strong privative clause, such as that contained in subsection 242.3(2) of the British Columbia *Financial Institutions Act*, to ensure the maximum possible deference by the courts in favour of decisions issued by the JPT.
- The JPT should be dedicated to pension matters only, to preserve its status as an expert tribunal in the eyes of the courts, thereby also enhancing the deference paid to its decisions.
- The purpose of the JPT should be to hear appeals from administrators and other "applicants" (being any party who has submitted a plan for registration, or any other person subject to the directive powers of the regulator) in respect of decisions of the regulator.
- The JPT should be independent and at arm's length from the governments.

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- The JPT should be bound by and able to establish precedents.
- The JPT should have balanced representation from both provinces.
- Members of the JPT should be appointed by the Lieutenant-Governors-in-Council in both provinces.
- The membership of the JPT should consist of a chair, vice-chair and other members, all of whom are recognized pension experts.
- The chair and vice-chair of the JPT could ultimately be full-time positions once appeal volumes are sufficient to justify it.
- There should be multiple members appointed, sufficient to respond to cases in a timely manner.

6.5.2 Joint Pension Advisory Council

6.5.2-A The governments should work together to establish a Joint Policy Advisory Council having the following characteristics:

- The JPAC should be a statutory body created under the pension standards statutes in each of the provinces, and its members should be remunerated according to government guidelines.
- The JPAC should be established on the "common member" model.
- The stated purposes of the JPAC should be to:
  - provide policy advice to the ministers and the superintendent(s);
  - recommend changes to the legislation in both provinces as needed and provide input and advice on proposed amendments;
  - provide advice to the superintendent(s) on the administration of the legislation and the development of regulatory policies and guidelines;
  - promote continued harmonization between Alberta and British Columbia; and
  - encourage national harmonization.
- The JPAC should be appointed jointly by and report to the two ministers on a regular basis in respect of its activities.
- There should be balanced representation from both provinces in the membership of the JPAC.
- The JPAC should be of a workable size that is not too big, for example with a maximum of nine members.

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- Membership on the JPAC should include representation from among pension plan sponsors, pension plan members and pensioners, professional service providers and government policy staff, with the Superintendent(s) sitting on the JPAC in an "ex officio" capacity.
- The position of chair of the JPAC should be a permanent position, designated as the "Pension Advocate", and be responsible for and accountable to the ministers with respect to:
    - chairing the Council;
    - promoting awareness of pensions, pension policy and retirement income planning among employers and employees, and promoting the expansion of pension coverage; and
    - promoting financial education with respect to pensions and retirement savings.
- Membership on the JPAC, other than the chair, should be for fixed staggered terms, resulting in regular turnover in membership.

6.5.3 Joint pension regulator

6.5.3-A The governments work towards the establishment of a joint pension regulator to administer and enforce, on a consistent basis in both provinces, the recommended harmonized pension standards legislation.

7.0 Governance and Investment

7.1 Governance standards

7.1-A The principles contained in CAPSA's governance guidelines should be adopted as a schedule to the legislation, in a way that explicitly incorporates them into pension law and makes them straightforward to update, as necessary. (See also Recommendation 6.1-G regarding adoption of professional standards.)

7.1-B Every plan should be required to have a governance policy. Plan governance policies should be required to be:

- approved by the governing parties;
- updated regularly;
- brought to the attention of members and other beneficiaries;
- available upon request to all members and other beneficiaries; and

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- available to the regulator upon request, but not required to be regularly filed.

Required elements of a plan governance policy should be specified, possibly in regulation – similar to the rules relating to the contents of a Statement of Investment Policies and Procedures (SIPP). At a minimum, plan governance policies should include:

- a profile of the pension plan: a summary of the plan's key features, its purpose, who makes contributions and how they are determined, how benefits are defined and determined and how the fund is established, held, managed and invested;
- a description of the key elements of the governance structure: the composition of any board, and the basis on which decisions are made and implemented;
- a summary of how business is to be conducted: timing, location and frequency of meetings, how a quorum is obtained, how meetings are to be recorded and how the voting system is to operate;
- a detailed description of the roles and responsibilities of each party included in the governance structure;
- a description of when and how the administrator may employ agents and advisors in carrying out its duties, including standards for the appointment, reporting requirements and evaluation of such agents or advisors;
- a listing of stakeholders and a description of their interests in the plan;
- the standards of performance expected of the administrator (including those expected of trustees, both individually and collectively), including:
    - a code of conduct that addresses expectations for meetings, relationships between trustees, with agents/advisors and with members
    - a policy regarding conflicts of interest
    - an assessment of educational requirements and training needs for those who have responsibility for aspects of plan administration
    - planning and performance measures
    - the use of agents and advisors
    - communication to stakeholders
- a funding policy (See also Recommendation 7.1-C below);

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- a SIPP (already required in current legislation); and
- a remuneration and expense policy for trustees, if applicable.

7.1-C Every pension plan that includes either a DB or "target" benefit provision should be required to have a funding policy. The funding policy should be part of governance policy and should be made available to the regulator for inspection upon request. However, it should not be required to be filed. Necessary elements of a plan funding policy should be specified, possibly in regulation – similar to the contents of a SIPP. At a minimum, plan funding policies should include:

- an explanation of the purpose of the policy;
- a summary of the risks to which the plan's funded status is exposed;
- a description of the policies adopted to protect the plan's funded position against the risks identified (e.g. asset valuation methodology, how economic assumptions are developed, funding margins, funding thresholds for benefit increases, decreases, etc.); and
- an explanation of how the funding policy was developed (the rationale for the policy selected to protect the plan's funded position against the risks identified).

7.1.1 Trustee / fiduciary education

7.1.1-A Administrators and trustees should be required to have and use the knowledge and skills required to fulfill their obligations.

7.1.1-B Individuals who have statutory fiduciary responsibility for pension plans should be required to obtain certification from suitable training programs within a suitable period after their appointment. Failing to meet the educational requirements within an appropriate timeframe should result in disqualification of the individual and loss of any "business judgment" defence that would otherwise have been available to the remainder of the board. (See also Section 7.3 "Fiduciary protection" below.)

7.1.1-C Educational programs to train individuals having statutory fiduciary responsibility should be further developed and offered at the post-secondary level in both provinces. With appropriate further development, completion of the courses should enable certification of the individuals.

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7.1.2 Disclosure to members

7.1.2-A The legislation should require that pension plan administrators disclose to members key information affecting the member's participation, obligations or entitlements, in accordance with detailed disclosure rules as prescribed in a regulation.

7.1.2-B The disclosure rules should be tailored to different plan types – a legislative requirement to disclose key information should be supported by specific rules for different types of plans and at a minimum, should state the occasions on which disclosure statements must be provided, what items must be in the statements for that type of plan and who should receive the information.

7.1.2-C Electronic methods of disclosure should be explicitly permitted in the pension standards legislation, subject to their effectiveness in transmitting information to members and other stakeholders, i.e. there may be a need to address disclosure methods for stakeholders that do not have computer access.

7.1.2-D Administrators should be required to notify members, in their annual statement, that the plan has a governance policy, that the policy is available for review and how the members may access the policy.

7.2 Investment rules

7.2-A Alberta and British Columbia investment standards should be "uncoupled" from the federal Schedule III, to remove quantitative restrictions on investment and increase reliance on the prudent investor principle.

7.2-B Specific rules in Schedule III that protect against conflicts of interest (related party rules) should be integrated into provincial legislation.

7.2-C The existing "prudent person rule" with respect to investment of pension plan assets should be expanded to incorporate a requirement for expertise. Plan assets should be invested in a manner similar to the way in which a prudent expert would invest them. If the required expertise is not possessed by the governing fiduciary, the plan should be required to seek and avail itself of an appropriate level of expertise, but must still have sufficient knowledge to understand and question the advice.

7.2.1 Environmental, social and governance (ESG) factors

7.2.1-A The fiduciary standard for the investment of pension plan assets should be amended to reflect the following wording: "Pension plan fiduciaries must

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make plan investment and other financial decisions in the best financial interests of plan members, former members and other plan beneficiaries, taking into consideration relevant factors only as they affect the potential risk and return of investments."

7.3 Fiduciary protection

7.3-A Elements of the CAP Guidelines that do not relate to investment choice should be legislated to apply equally to all plans, including those that do not offer member investment choice. (See Recommendation 7.1-A above.)

7.3-B The legislation should explicitly state that "auto-enrolment" and "auto-escalation" are permitted and are not actionable in and of themselves.

7.3-C The provision of one investment vehicle only should not, in itself, be actionable unless the selection has not been made and monitored with due diligence.

7.3-D Plan fiduciaries who can demonstrate that they are compliant with the requirements of a "pension judgment rule" in the legislation should have a statutory defence against claims in respect of their decisions in the same manner that corporate directors are protected by the business judgment rule.

8.0 Funding and Benefit Security

8.1 Defined benefit plan funding rules and surplus ownership

8.1.1 DB funding rules

The Panel recommends that

8.1.1-A Pension standards should continue to require both solvency and going-concern valuations, with reasonable requirements that protect benefit security while not being overly onerous for sponsors, as further described below:

Going-concern funding requirements

8.1.1-B Current going-concern funding rules should continue to apply and be determined by the plan actuary and the plan sponsor, based on the plan's funding policy (See also Section 7.1 "Governance standards" above), actuarial standards of practice and regulatory requirements.

Solvency funding requirements

8.1.1-C Solvency funding rules should be developed on the following bases:

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- Asset valuations should be based on pure market measures (with no smoothing of assets).
- Liability valuations should be prepared on a pure wind-up basis, assuming annuity purchases for persons receiving or eligible for

  immediate pensions and termination (commuted) value otherwise. Benefits provided at the discretion of the administrator/trustee/plan sponsor should not be included in the valuation.
- Assumptions should be based on the actuarial standards for calculating commuted values that would be adopted in the legislation. (See also Recommendation 6.1-G above.) No additional margins or provisions for adverse deviation (PfADs) should be required, other than those already implicit in the commuted value.
- Amortization of any solvency deficiency should continue to be over five years; however, assets to satisfy the deficiency could include letters of credit or assets in a PSF. (See Recommendations 8.1.2-A and 8.1.2-C below.)
- Solvency valuations should be required annually unless, at any valuation, plan solvency was 110 percent or greater, in which case the next valuation would not be required for three years.

8.1.2 Ownership and use of surplus

Pension Security Funds

8.1.2-A Pension standards legislation should permit the establishment of a "pension security fund" (PSF) that would be separate from but complementary to the regular pension fund, on the following bases:

- Contributions required to meet going-concern funding obligations should be forwarded to the regular pension fund as under current practice.
- Contributions required to meet solvency obligations over and above the going-concern obligations could be forwarded to the PSF.
- The PSF should be:
  - tax sheltered, held separate from the sponsor's assets and protected from creditors;
  - accessible to the plan sponsor with regulator consent:
    - as long as the sum of the regular pension fund plus the PSF (after access by the sponsor) exceeds the funds required to meet solvency requirements, with a five percent cushion, and

the withdrawal is spread over a five-year period (20 percent of the excess per year)

- based on a current valuation within one year of the most recent valuation date
- but only if an actuarial certification that there has not been a material change since the valuation date is provided

▪ returned to the plan sponsor on plan windup, to the extent not needed to meet benefit obligations and windup expenses.

- The PSF could also hold voluntary sponsor contributions greater than those required to meet solvency obligations, to assist in managing contribution volatility.
- The PSF could be structured as a trust, insurance contract or other financial funding medium acceptable under the federal *Income Tax Act*. (See Section 10.1 "Income tax rules" below.)
- The governments should consult with the CIA regarding detailed rules on PSFs (including certification requirements and frequency of valuations).

Contribution holidays/surplus withdrawals – regular fund

8.1.2-B Contribution holidays in relation to, and surplus withdrawals from the regular pension fund would be permitted, on the following bases:

- Contribution holidays should be permitted unless explicitly prohibited in the plan terms.
- Surplus withdrawal from the regular fund should continue to be permitted subject to regulator consent and only if the plan permits it or the members consent.
- Contribution holidays and surplus withdrawals should be restricted to ensure that they do not reduce surplus assets to less than five percent of the value of the liabilities as of the most recent review date.
- The financial position of the plan should be required to be updated (based on changes in interest rates and actual investment returns) before the withdrawal can be made or the contribution holiday can commence.
- Both contribution holidays and surplus withdrawals should be required to be spread over five years (20 percent of the excess per year).
- For the holiday or the withdrawal to continue after the first year, the financial position of the plan, the calculation of the five percent buffer

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and the amount of the surplus available should be required to be updated annually in a similar manner.

- Where a PSF had been established, a contribution holiday should be permitted in the regular pension fund:
  - to the extent that funds are in excess of going-concern requirements; and
  - as long as the sum of the regular pension fund plus the PSF (after the contribution holiday) exceeds the funds needed under the solvency valuation based on a 105 percent threshold.

See Section 10.1 for recommendations relating to income tax limits on surplus assets.

Letters of credit

8.1.2-C Letters of credit should continue to be permitted for use in securing solvency deficiency obligations.

Legacy surplus issues

8.1.2-D Plans with "legacy" surplus issues should be permitted to "ring-fence" such issues by allowing the older plans to be frozen and new plans to be established with clear contractual provisions relating to surplus issues to "wrap around" the frozen plan, on the following bases:

- The terms and conditions of the new plan with respect to surplus use and withdrawal should be subject to contract law.
- The existing plans, whose surplus use and withdrawal rules were governed by trust law, should be permitted to be closed to new entrants and frozen with respect to accruals of further service and recognition of salary increases.
- Recognition of vesting and other entitlements in the old plan should be required for the purpose of establishing benefit entitlements in the new plan, and vice versa.
- Benefits in the new plan should include recognition of salary increases with respect to service accrued in the frozen plan.
- There should be no requirement to wind up the "legacy" plan, but rather it would continue and form part of the members' ultimate benefits from the two combined plans, continuing to pay out benefits until all liabilities are discharged.

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8.1.3 Utilization of plan assets

General rules

8.1.3-A The governments should adopt the following principles in the legislation for asset utilization:

- Established property rights to surplus that is in a plan at termination should not be tampered with.
- At all times if a pension plan sponsor and members want to define their "deal" regarding surplus ownership and utilization in some other fashion, they should not be precluded from doing so.
- Surplus in an ongoing plan should be available to the plan sponsor for contribution holidays unless the plan explicitly prohibits it.
- Withdrawal of surplus by the plan sponsor should take place only if the plan permits it or the employees agree; the withdrawal should be subject to regulator approval.
- Surplus in new "wrap-around" plans and in PSFs should be dealt with as described in the Recommendations under Section 8.1.2 above.

The governments should build upon these principles as the body of common law evolves with subsequent court decisions.

Partial plan terminations

8.1.3-B The following rules should apply with respect to surplus use and distribution on partial plan terminations:

- Vesting of benefits should be automatic for all members affected by a partial termination but vesting should not include a right to surplus assets unless the plan specifically provides for it.
- Partial terminations should continue to be required, subject to the criteria in the current legislation (termination of an identifiable group, etc.).
- Administrators should be required to notify the regulator of a plan termination rather than being required to file a special report; the actuary of a DB plan should also report the event on a subsequent regular valuation.

Plan mergers and divisions

8.1.3-C The following rules should apply to plan mergers and divisions:

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- A plan should be permitted, but not required, to transfer a proportion of the surplus equal to the ratio of the liabilities for the transferred members to the total of the plan's liabilities.
- The money transferred into the transferee plan should be allowed to be used according to the terms of the new plan.

Plan expenses

8.1.3-D Plan expenses should be payable from the plan fund unless the plan text specifically provides otherwise. This default rule would supplement the current standard requiring all plan texts to contain a provision indicating how plan expenses will be paid. It would address problems in old plans with unclear or nonexistent wording.

Re-opening closed plans

8.1.3-E Employers should have the ability to reopen a plan previously closed to new members unless the document of the closed plan was explicit that it could not be reopened.

DB/DC contribution holidays

8.1.3-F Where a plan has been converted from DB to DC leaving a legacy DB provision in place within the plan, surplus arising with respect to the DB provision should be available for employer contribution holidays in the DC portion of the plan as long as the DB and DC segments are part of the same trust (to the extent that the plan assets are subject to a trust). (See also Recommendation 8.1.2-B regarding the use of surplus for contribution holidays.)

8.2 SCTB funding and related rules

Funding rules for SCTBs

8.2.1-A A new category should be created in the pension legislation for funding and disclosure for single and multi-employer plans with similar characteristics, called specified contribution target benefit plans. The essential characteristics of such a plan would be:

- Contributions are limited to specified employer and employee contributions ("specified" by the parties to the deal, whether through a collective bargaining agreement or another method).
- Employer(s) are limited in their liability to providing the specified contributions.

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- There is a formula benefit set out in the plan document but it is subject to reduction if funding is not sufficient and can therefore be considered a target benefit.

8.2.1-B There should be a single funding test for the purpose of setting minimum funding standards. It should be a "going-concern plus" test:

- Going-concern liabilities should be estimated using "best estimates" of long-term going-concern assumptions, following generally accepted actuarial practice.
- The actuary should have to demonstrate that the plan has an appropriate PfAD. The variables at issue could include, but not necessarily be limited to:
  - distribution of liabilities between active and deferred/retired members
  - degree of mismatch between assets and liabilities, and
  - variability of hours worked
- The greater the volatility of the above variables, the greater the PfAD needed. The result would be a target going-concern funded ratio of 100 percent at minimum, rising with the degree of PfAD.
- The funding rules should either specify the magnitude of the PfAD or incorporate actuarial standards addressing the same issue. As actuarial standards are yet to be developed in this area, the CIA should be asked to develop such standards or at least to advise legislators on appropriate PfAD standards.

8.2.1-C To determine the size of the PfAD and the prescription for remediating problems, the funding rules should require that stress testing be performed as part of the actuarial valuation:

- The standards should require the actuary to perform all appropriate scenario tests which must include both stochastic tests, and specified deterministic scenarios.
- Standards for stochastic testing should have to state what level of statistical confidence would be required.
- Where the plan would be vulnerable to the failure or withdrawal of one or more employers, that scenario should be included in the stress testing. Proportionate and appropriate protection should be factored in where there is an apparent significant chance of wind-up.

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- It is important that the actuarial profession be engaged to develop stress testing metrics. Actuarial standards do not currently exist in this area; therefore, the CIA should be asked to create such standards. If the profession declines to create such standards, the legislation should impose them based on advice from actuarial consultants.

8.2.1-D If going-concern liabilities plus any necessary PfAD are greater than assets, deficiencies should be required to be eliminated by increasing contributions and/or reducing benefits so as to restore the plan to the target funded ratio. The remediation should be required to be achieved with regular, consistent and timely treatment:

- The plan should have to demonstrate that contributions would be sufficient to amortize unfunded liabilities over 15 years or the "expected average remaining service life", whichever is less. The other rules relating to unfunded liabilities would continue to apply:
  - Once identified, an unfunded liability should be required to be amortized in that length of time or less and should not be allowed to be combined with more recently established unfunded liabilities so as to extend the amortization period beyond the original maximum period.
  - Gains should be required to be applied to the oldest-established unfunded liability first, with the result that either the payments would be lowered or eliminated, or the same payments would continue but the unfunded liability would be amortized more quickly.
- If funding levels indicated above are not met, the plan's funding status should be required to be adjusted immediately by contribution increases, changes in plan design (e.g. benefit reductions or increased eligibility requirements) or a combination of those. The trustees should have the primary responsibility to exercise even-handedness in making any changes in plan design.

Benefit Improvements for SCTBs

8.2.2-A The legislation should also require that a reasonable method be used for costing benefit improvements: benefit improvements should be valued on the same going-concern-plus basis as required for the minimum funding standards.

8.2.2-B No benefit improvement should be permitted unless there is at least a 100 percent going-concern-plus funded ratio and no benefit improvement should

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be allowed that would reduce the plan's funded status below the fund's target ratio.

8.2.2-C To provide more flexibility in plan design, temporary benefit improvements should be permitted, subject to the general limitation that there must be a going-concern-plus surplus. These improvements must be accompanied by full disclosure to plan members of the temporary nature of the benefit and who is entitled to receive it. Such improvements should be subject to Recommendation 8.2.2-B limiting benefit improvements.

Valuations for SCTBs

8.2.3-A The current standards for frequency of valuations should be retained. The regulator should continue to have discretion to require more rigourous and/or more frequent valuations and/or additional stress testing as part of risk-based monitoring.

8.2.3-B In any SCTB plan where the probability of wind-up is higher, the actuary should be required to take into account the wind-up scenario in setting the going-concern-plus assumptions. The more probable the windup scenario the closer the going-concern-plus valuation should be to a wind-up valuation.

8.2.3-C The valuation filed with the regulator should state the target funded ratio and how it was calculated, including making the PfAD explicit.

8.2.3-D The valuation should be required to include an estimate of the amount that would be required to settle all liabilities at that point in time (settlement valuation), and state the settlement ratio.

Allocation of Assets on Wind-up of an SCTB

8.2.4-A In the event of a wind-up, every beneficiary (active, deferred or retired) should receive a portion of the total wind-up assets as determined by the trustees. The Panel makes no recommendation about how to calculate the wind-up liability for each beneficiary, and does not recommend any change in the hierarchy of priority currently in the legislation for discharging liabilities in accordance with the degree to which benefits are funded. The trustees should have the primary responsibility to exercise even-handedness.

Transfer values

8.2.5-A An individual's termination benefit should be valued using the same assumptions as were used in the most recent valuation, that is, on a going-concern-plus basis.

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8.2.5-B The maximum termination benefit any individual may receive should be 100 percent of the going-concern liability. Even if the current funded ratio is over 100 percent to meet the plan's target funded ratio, the maximum payment should be 100 percent. If the ratio is less than 100 percent, terminating members who elect to remove their funds should receive a pro-rated amount, based on the funded ratio at that time. There should be no later "catch-up" payment to bring their payment to 100 percent of the target benefit.

SCTB Governance

8.2.6-A Our recommendations relating to governance standards in Section 7.1, and trustee/fiduciary education in Section 7.1.1, should be adopted to complement these funding rules. We do not endorse any single governance structure as the most suitable.

8.2.6-B As indicated in Recommendation 7.1-C, a funding policy should be a mandatory element of the governance policy for these plans. Some of the special requirements related to funding policies for SCTBs should include:

- There should be a policy on benefit increases.
- The legislation should require that the actuary, in the actuarial report, opine that there is nothing in the funding policy that is inconsistent with sound actuarial practice for the particular plan.

8.2.6-C The governing fiduciary should be required to certify that the plan has been managed in accordance with its governance policy, funding policy and investment policy.

8.2.6-D There should be a requirement for an annual assessment by the governing fiduciary of the plan's administration, its compliance with legislated minimum standards, governance, funding and investment policies, and the performance of the trustees, administrative staff and significant external professionals. The assessment should be in writing and available to the regulator upon request, but should not be required to be filed.

8.2.6-E Governing fiduciaries should be required to obtain the education and training required in order to properly meet their responsibilities (See also Recommendation 7.1.1-B.)

8.2.6-F Governing fiduciaries should be required to ensure that those with administrative responsibilities with respect to the plan are appropriately trained.

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SCTB disclosure to members

8.2.7-A The SCTB's settlement ratio should be required to be disclosed annually to all persons with entitlements under the plan:

- The disclosure must explain the contingent nature of the target benefit and the circumstances under which it would be necessary to reduce plan benefits.
- Disclosure of the settlement ratio should be accompanied by an explanation of what it means: that it is the percentage of the target benefit that members as a group would receive if the plan were to wind up or if they remove their funds from the plan voluntarily, and that each individual's benefit may be higher or lower than that percentage, depending on the trustees' determination of how benefits should be allocated.

8.3 Temporary measures

8.3-A The legislatures should continue to delegate to the Lieutenant Governors in Council the power to exempt plans or those responsible for them from the normally applicable standards, and impose alternate standards. Governments should continue to use their power to provide temporary relief in exceptional circumstances broadly affecting all pension plans.

9.0 Specific Pension Standards

9.1 Locking in

9.1-A Unlocking of funds subject to pension standards legislation in Alberta and British Columbia should only be permitted on the following bases:

- Pension funds should remain locked in so long as the individual is still an active member of the plan.
- SCTBs should retain the ability to set rules regarding when an individual is or is not a terminated member.
- It should be optional whether a plan permits unlocking.
- If a plan permits unlocking, individuals who are at least age 50 should be permitted to unlock either 25 percent or 50 percent of their entitlements, on a one-time basis, at or after termination of employment. The unlocked amount could be transferred to a non-locked in RRSP, while the locked in portion could be transferred to a LIRA or locked-in RRSP.

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- If the plan is silent on unlocking, then 50 percent unlocking at age 50 or over at the member's election should be the default.
- There should be no change to the existing rule that plans may disallow portability within 10 years before normal retirement.
- For transition purposes, individuals subject to the current Alberta legislation who are age 50 or over at the time the new legislation is enacted should be "grandfathered" under that rule regardless of the option selected for the plan going forward.
- There should be no change to the existing unlocking rules (subject to harmonization) with respect to:
  - shortened life expectancy;
  - non-residency in Canada; and
  - small amounts.
- Financial hardship unlocking should be applicable in both provinces using the Alberta model.

9.2 Standards requiring harmonization and standards perceived as "irritants"

9.2-A The specific pension standards identified in Appendix C to this report should be revised and harmonized on the basis indicated in Appendix C.

9.2-B In ultimately developing harmonized next-generation pension standards legislation, the two governments should conduct a full review of all provisions of the existing statutes in both provinces to determine which additional provisions require alteration, elimination or harmonization, consistent with the objectives and principles of that new legislation.

10.0 Related Legal and Other Frameworks

10.1 Income tax rules

10.1-A The governments should actively advocate that the federal government change various tax rules that impact the pension system, including:

- raising the maximum contribution/benefit limits (to be more competitive with other major industrialized economies with which we compete for human resource talent)
- raising the maximum funding limits for DB plans to encourage more generous funding of such plans and improve benefit security, by

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allowing surpluses of up to 25 percent, except for Individual Pension Plans, where the current ten percent maximum excess would remain

- advocating any changes required to federal tax and bankruptcy and insolvency laws to support establishment of the Pension Security Fund
- updating the rules applicable to the maximum transfer values for DB to DC plans to allow larger amounts to be transferred tax-free
- making the tax rules flexible enough to accommodate new plan designs that meet the principles of general application under next-generation pension standards legislation
- allowing contributions by employees to broad-based plans to be deductible where their employer opts not to participate (see Sections 6.3 and 11)
- allowing self-employed individuals to make contributions to a registered pension plan

10.2 Accounting rules

10.2-A Canadian accounting standards should not follow IFRS standards for reporting on DB plans.

10.2-B The two governments should re-engage the CICA in discussions on the impact of accounting rules changes on plans and the adoption of the IFRS standards in Canada.

10.3 Division of pensions on spousal relationship breakdown

The Panel recommends that:

10.3-A Pension division should be made using the immediate settlement method for benefits from DC plans.

10.3-B However the issues surrounding the choice between the deferred and immediate settlements for DB and target benefit plans are resolved, any solution should recognize the social policy of pension coverage and take into consideration the role of the plan sponsor and the impact of the rules on the sponsor and the pension plan. The objectives should be to remove barriers to the maintenance of plan coverage and simplify administration from the perspective of pension plans and plan sponsors, while respecting the character of a pension benefit.

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10.3-C Pension standards legislation should make clear that the costs incurred in effecting the division, including professional fees and any ongoing incremental administration costs, should be borne by the member and spouse, and not by the plan (and, by implication, the other members) or the sponsor, on the basis that relationship breakdown and its implications are neither the plan's nor the sponsor's issue, and they should not be unduly burdened as a result.

10.3-D Next generation pension division rules, in whatever legislation they may be housed, should:

- be simple and easy to administer on the part of the plan administrator;
- not require the exercise of discretion or judgment by the plan administrator in interpreting orders or agreements;
- not require the administrator to obtain professional advice;
- not impose positive obligations on the sponsor or administrator beyond provision of specified information and the payment of benefits that the order or agreement requires be paid;
- be based on a clear, straightforward formula using a standard form of "fill in the blanks" order that it is easy for the parties and their counsel to understand and practical for the administrator to manage; and
- prescribe the form of pension division addendum to any matrimonial property division order or agreement contained in either pension standards or family relations legislation.

10.3-E If the spouse is to be entitled to become a "limited member" of the pension plan, that status should be granted for the purpose of collecting benefits described in the property division order or agreement only, and not for any other purposes. Such limited members should be entitled to receive annual statements such as those provided to the member spouse in respect of the limited member's benefit entitlements under the pension plan. After receiving the full payment of the benefit required by the property division order or agreement, the spouse should have no further claim under the plan.

10.3-F Pensions standards and family property legislation should confirm the ability of the parties, by agreement, to contract out of pension division and decide on an alternative approach to dividing their family assets.

Appendix D (continued)

10.4 Bankruptcy and insolvency

10.4-A There should not be a pension benefit guarantee fund established in Alberta and British Columbia.

10.4-B The governments should encourage the federal government to extend the "super priority" secured creditor status to all due but unpaid contributions, including solvency deficiency or unfunded liability special payments, but not to extend such status to such amounts that are unamortized but not yet due .

10.4-C The governments should encourage the federal government to provide the PSF with the same treatment under federal bankruptcy and insolvency legislation as applies to the regular pension fund of a pension plan. (See also Section 8.1.1 "DB funding rules" above).

10.4-D The deemed trust rules in pension standards legislation need to be clarified to ensure that monies held for pension contributions are treated in the same manner as earned but unpaid wages under provincial employment standards legislation and, in situations other than bankruptcy, are not available to satisfy other creditors.

10.5 Financial education and literacy

10.5-A The governments should work to build and expand on existing programs, and explore opportunities for earlier introduction of financial skills education in the public school system. Due to the importance of early education, we recommend expanding financial life skills instruction to the primary school level and that it be a regular component of curricula throughout the public school years.

10.5-B The governments should work to ensure that teachers are properly equipped to teach financial literacy skills.

10.5-C There should be a clear mandate within the governments for improving consumer education and financial literacy, including government-led "financial literacy campaigns", and a comprehensive strategy for adult education in financial skills.

11.0 The "ABC Plan"

11-A The governments should establish a Steering Committee made up of experts in pension plan administration, governance and investment to examine the feasibility of establishing a multi-employer pension plan available to all

Appendix D (continued)

employers and employees working in our provinces. The Steering Committee should have a mandate not only to make specific plan design recommendations but also to suggest the means by which key participants (especially employers and employees) in the ABC Plan operation would work together to ensure their buy-in to the ABC Plan's purposes and objectives. We also encourage the Steering Committee to consult with other provinces who may be considering similar plans.

11-B The ABC Plan design should be based on a simple DC formula with, generally, matching employer and employee contribution rates. Although the Panel recommends an entry level participation rate of a minimum of three percent of employee's earnings, the Plan design should be flexible enough to allow both employers and employees to make contributions without matching contributions from each other in order to encourage increased savings by all ABC Plan participants.

11-C All employers and workers, including self-employed individuals earning employment or self-employment income in either Alberta or British Columbia, should be eligible to participate in the Plan. All employers and employees should be automatically enrolled in the ABC Plan but the employer and/or their employees should be allowed to opt out of participation if they so choose. Employees whose employer has opted out should still be automatically enrolled without employer contributions unless they choose to opt out. Self-employed individuals in our provinces should also be encouraged to participate in the Plan. Auto-enrolment is not recommended – rather, participation by self-employed individuals should be on an opt-in basis.

11-D The Steering Committee should explore options to create incentives for employers who do not already provide a pension plan not to opt-out of participation in the ABC Plan.

11-E Eligibility for membership in the Plan could be based on a minimum earnings threshold. Membership would be available to anyone between the ages of 18 and 71.

11-F Governance of the ABC Plan should be at arm's length from government. There are several models of pension governance that the governments could consider.

11-G The majority of the board of governors should be experts in the pension industry, and the rest should represent employer and employee groups to give the governance the transparency and depth necessary to properly manage the ABC Plan. Trustee qualifications should be strictly enforced to ensure that

Appendix D (continued)

all trustees have the appropriate expertise to fulfill their responsibilities. (See Section 7.1.1 "Trustee/fiduciary education" above.)

11-H Administration of the Plan should be at arm's length from government. The board of governors would ultimately be responsible for deciding how best to structure the administration of the Plan.

11-I The Panel does not recommend that employers or employees contributing to the ABC Plan have any investment choice. Rather, the Panel recommends investment of the Plan assets would be subject to the policy direction of the board of governors.

11-J The Plan's design could include auto-annuitization, spreading out annuity purchases over time to minimize longevity risk and retirement end-date sensitivities which would help mitigate risks of market volatility.

11-K Custodianship of the Plan assets must also be independent from government. Current well-established financial institutions are well positioned to act as custodians of some or all of the ABC Plan assets, and should be considered as key players in the ABC Plan structure.

11-L Contributions to the ABC Plan should be locked in similar to the locking-in rules applicable to any registered pension plan in our provinces.

11-M Vesting of employer contributions to the ABC Plan should be immediate.

ABC