College and University Retiree Associations of Canada | Associations de retraités des universités et collèges du Canada

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SUBMISSION TO THE ONTARIO EXPERT COMMISSION ON PENSIONS

This brief from the CURAC/ARUCC Board concerning Ontario pensions is addressed to the Ontario Expert Commission on Pensions. As the only national Canadian federation of post-secondary retiree organizations, CURAC speaks for the interests of some twenty thousand retired faculty and staff in associations on sixty campuses of our major academic institutions in every Canadian province. Among these, our Ontario member organizations include 14 retirees' associations of Ontario universities, and the federation of Ontario college retiree organizations known as: the Ontario Colleges of Applied Arts and Technology Retirees' Association. This is a CURAC constituency of some 9,000 pensioners, from about 26 campuses in Ontario.

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A. Preliminary Remarks:

The last major revision of the Ontario Pension Benefits Act (PBA) was in 1987, a reform, according to one observer, that "considerably expanded the rights of plan members . . . [thus altering] the power balance between employers and employees in the matter of pensions." [Gilles, 1996, "Pension Plans and the Law of Trusts," *The Canadian Bar Review 75*: 221- 250]. Unfortunately, pension regulation in Ontario remains heavily skewed in favour of employers. Although occupational pensions play an important role in providing income security for Ontarians, retirees and pension plan members in the Province enjoy very limited rights to control or to the influence the terms, administration or the investments of the plans to which they belong. In the last twenty years, many desirable goals of the PBA still have not been fully realized. It is timely, therefore, to undertake this review of the regulation of defined benefit pensions in Ontario.

B. The Changing Economic Environment:

Over the past two decades, many changes have occurred in the economic environment affecting pension-fund performance, changes which it was obviously difficult to anticipate in 1987; among them:.

Unindexed pensions have lost approximately 40 percent of their purchasing power to inflation.

Interest rates have dropped to levels not experienced since the early 1950s. The major consequence for pension plans is greatly to increase the likelihood of solvency deficits, because PBA regulations require present value calculations of pension fund liabilities to be based on a lower discount rate.

The large federal deficits on the public accounts twenty years ago, and the resulting increases in public debt, have been replaced by large surpluses and energetic public debt reduction. The Federal Government should now be far less revenue-conscious than it was in the eighties and nineties; this should facilitate financial manoeuvrability and regulatory solutions to some current pension problems.

Mandatory retirement is rapidly disappearing, and this change will very likely slightly raise the average age of retirement. Although employees who continue to work will have their number of years of pensionable service increased, this will not alter their life expectancy. Hence they will receive on average an enhanced monthly pension, but over a shorter period. This will have mixed effects on defined benefit pension plans, effects which will have to be seriously researched.

Part-time employment—in the academy as elsewhere--has greatly increased in the labour force, with negative consequences for the income levels of those so employed and thus for their pension entitlements. Again, the implications must be carefully studied.

C. Pensioners' Interests:

We wish to underline that real differences of interest prevail between pensioned retirees and active employees with future pension entitlements. This is despite the fact that most of them in each institution belong to the same pension plan, subject to the same actuarial

rules and the same pension committee decisions. Retirees in defined-benefit plans rely directly on their monthly pensions. Most retirees have little or no say regarding the administration of their pension plans after retirement, and they possess almost no leverage to prevent adverse changes in their terms or in the interpretation of their terms. Active employees who are plan members, on the other hand, have well-funded associations or unions with which to negotiate, arbitrate or litigate changes, with the usual power of collective action.

The only method for retirees to improve their monthly pensions — even to approximate increases in the cost-of-living — is through pension indexation. Retirees without guaranteed indexation or performance-linked indexation must rely on the ad-hoc sympathy of the employer and the support of their active fellow members of the plan for ongoing indexation. For these reasons, pensioners' interests must be protected and defended, indexation should be supported by regulation, and there should be some assurances through regulatory requirements that these pension guarantees will continue to prevail over the coming decades.

At the same time, it is obvious that modification of pension arrangements that benefit retirees will also be beneficial in future for active plan members, who are retirees-in-waiting. Our suggestions will therefore be pertinent to the pension plans of all employees, active and retired

D. CURAC Priority Pension Issues:

The Commission's Discussion Paper, *Reviewing Ontario's Pension System*, poses sixty questions in nine categories. In addition, the Commission's Terms of Reference [TOR] identifies under six headings 18 further "Issues to be Addressed in the Report." Despite the overwhelming detail in these Commission questions, the most significant priorities for retirees – issues that are also important for active plan members and for plan sponsors – are touched on only marginally. These priorities are the following:

1. How can pension regulation be restructured to promote outstanding long-term investment performance by pension funds?

2. How can pension regulation best promote full indexation of pension entitlements?

3. How can the effective involvement of retirees and of active plan members in the administration and management of their plans' assets be enhanced?

We address these issues here, and make recommendations. After each of the Brief's sub-headings (**1.1** to **3.2**), we indicate in brackets the item number from the Commission's Terms of Reference (TOR). We shall comment on items 1, 3, 7, 8 and 18 of the Terms.

E. Discussion and Recommendations:

1.1 Pension Plan Funding: Enhancing the Viability of Defined Benefit Pensions in Ontario by Improving the Performance of Pension Investments [TOR #18]

Good investment returns are essential for pension fund health. They enable indexation of pensions, improvement of plan provisions and reduced employer pension contributions. This is because the funding of a mature pension plan comes one-third or less from contributions and two-thirds or more from investment earnings. The duration of the liabilities of most pension plans is roughly 16 years, a length of time over which equities will generally deliver annual returns two to six percent higher than fixed income investments. On the other hand, returns on equities are more volatile, particularly over short periods.

Well-managed large pension funds, such as the Canada Pension Plan and the Ontario Teachers' Pension Plan, have already shifted their portfolios substantially toward holding a high proportion of equity and equity-like assets. The most successful institutional investment managers in North America, like David Swenson at Yale University, today hold less than 10% of their portfolios in bonds, because of the poor risk-reward characteristics of this traditional asset class. These managers control volatility by diversifying into other asset classes, primarily into private equity, absolute return investments and real estate.

On the other hand, smaller pension plans in Canada continue to hold a relatively large proportion of fixed income investments, partly because the prevailing pension wisdom mandates and pension regulation emphasizes traditional investment practices and partly because they are small. This penalizes their sponsors, their pensioners, their active members and, possibly, taxpayers as well. They need encouragement to emulate the large plans; and they may need institutional innovation to enable them to so do. This is our rationale for recommending changes to legislation and regulation that will promote a somewhat more risk-tolerant long-term investment perspective for pension funds, while hedging against short-term investment volatility by the methods used by large well-managed pension funds.

Recommendation #1:

Regulatory disincentives to investing for the long term should be eliminated, and pension fund trustees encouraged to deal more flexibly with the mix of equity and fixed-income investments.

* * *.

Small pension funds need help to secure some of the advantages of greater size. For example, investment management fees depend on the amount of assets to be managed, some interesting asset classes for diversification may be inaccessible for small

institutions, investment expertise is expensive if the costs must be met on a small asset base. One way of addressing these problems is through setting up a public investment fund.

Recommendation #2:

Serious consideration should be given to establishing a public-sector investment fund for Ontario that would have the mandate to accept assets from Ontario pension funds on a voluntary basis, and to invest these in ways that reduce market risk for participants while maintaining long-term returns.

Such a fund could operate in a manner somewhat analogous to re-insurance for a casualty insurance firm, enabling smaller pension plans to transfer some investment risk to a much larger well-managed fund.

1.2 Enhancing the Viability of Defined Benefit Pensions by Reducing Regulation

[TOR #18]

The administration of a defined benefit pension plan in most provinces, including Ontario, is time-consuming and onerous, since such plans are regulated provincially – with the broad goal of ensuring that pension promises will be met – and regulated at cross-purposes by the CRA, which apparently wants to limit tax losses that arise through deferral of income tax on pension contributions and earnings. The conflict between provincial establishment of minimum pension benefit standards and Federal restrictions on pension benefits and pension plans reveals a patchwork of federal and provincial legislation and regulation that has long – and justly – been criticized for being costly and retrogressive.

Federal pension regulation under the Income Tax Act is extraordinary complex and sweeping, limiting contributions, transfers, maximum pensions (in several dimensions) pension deferrals, and many other matters. As it has mushroomed over the last generation, it has imposed major compliance costs on defined benefit pensions and pension sponsors. These ever increasing DB compliance costs are a major reason for switching to a DC pension plan.

The excessive development of Federal regulation of private pension plans has also reversed the broad thrust of Federal policy with respect to pensions from the 1960s. When the Federal government set up registered retirement savings arrangements at that time, it recognized that the general welfare of Canadians would be well-served by encouraging private savings for retirement. As the population ages, life expectancy increases and the baby- boomers gradually reach retirement age, occupational pension arrangements and registered retirement vehicles have become even more important as an element of social policy than forty years ago. The “tax expenditures” (by government) involved in deferring income tax for lengthy periods remain significant, but must be viewed in the current context of great fiscal flexibility. Furthermore, tax expenditures to support worthy goals, such defined benefit pension plans, are scarcely unique. Tax expenditures also support mineral and petroleum exploration, wind power development, installation of insulation, sale of books, and many other goals. So there is no reason why they should not continue to support defined benefit pension arrangements generously.

The CRA started two years ago to ramp up enforcement of its pension rules, imposing new compliance costs on defined benefit pension plans. Yet most, if not all Federal pension regulation infringes on provincial jurisdiction and no longer is needed to protect Federal revenues (if it ever was). Ontario is in the strongest position to bring this unnecessary and generally counter-productive Federal activity to an end. Ontario should make direct representations to the Federal Government and should seek the cooperation of other provinces to achieve the following:

Recommendation #3:

The Federal Government should be persuaded to phase out all CRA regulation of defined benefit pension arrangements that are provincially regulated.

We fully realize that some Ontario PBA regulations interact with the Federal regulations; that such a major change would take time to implement; and that Federal authorities may be reluctant to act. Yet this change would do more to make defined benefit pensions viable in Canada than any other conceivable action.

* * *

The Ontario regulations under the Pension Benefits Act [“R.R.O. 1990, Regulation 909] – excluding the Schedules relating to Income Funds and the special regulations relating to Stelco and Algoma – comprise about 100 pages. Most of these regulations relate to defined benefit pension plans. Given the diversity of pension arrangements, considerable regulation is doubtless necessary**.** We note with dismay, however, that at least one regulation [Regulation #9] directly encourages conversion of DB plans to DC plans by permitting the employer to capture any surplus in the DB plan that remains after conversion. Furthermore, other Ontario PBA regulations, as well as some provisions of the legislation – notably with respect to indexation of benefits – are unclear, but appear to work against the goal of ensuring that pension promises are kept. By engendering legal uncertainty, they inevitably generate litigation.

Recommendation #4:

The Commission should review Ontario’s PBA Regulations that deal with defined benefit pension arrangements with the goal of making the rules simpler, clearer and more effective in protecting active and retired plan members.

Recommendation #5:

Regulation #9 should be modified so as to eliminate the encouragement it currently provides to convert DB and hybrid pension plans into DC plans.

1.3 Enhancing the Viability of Defined Benefit Pensions by converting a regime of long-term plan deficits into one with long-term plan surpluses [TOR #18]

Fluctuations in surpluses of pension plans are a genuine problem for a long- term investment policy, a problem artificially created in large part by an inflexible Federal CRA ‘going- concern’ surplus cap imposed on pension plans. Introduced a generation

ago to limit the revenue lost through deferral of taxing pensions, the surplus cap was sold on the grounds of "tax fairness." It generally forces employers to halt pension contributions if the "going-concern" surplus reaches 10% of the pension fund's liabilities, threatening that otherwise the plan may be de-registered. The forced dispersal of "excess" surpluses that arise from good performance leaves pension funds in danger of bad-year deficits, some so large as to threaten the future of those institutions. As we will discuss below, Ontario pension regulation is flawed in this respect, as well.

Many DB pension plans have suffered from on-going plan deficits since the beginning of this decade because the technology-driven investment "bubble" of the late 1990s burst: Both the TSE and the NYSE fell by 30% over the 13 months from August 2000 to September 2001. During the bubble many plans were forced by the Federal CRA surplus cap to take contribution holidays. Other plans were induced by large surpluses to do this. (See below, under heading 2.4.) As investment markets turned sour and surpluses turned into deficits, many plan sponsors were slow to resume normal contribution levels. The high performance expectations generated by the previous long bull market may have provided a disincentive to controlling deficits.

Combining the effects of poor investment returns with lack of employer contributions, drawdowns of pension plan assets by 20-25% were not uncommon – enough to convert a 10 percent surplus into a 15 percent deficit at market values. Viewed in a different time-frame, the ratio of pension fund assets to liabilities deteriorated by about five to six percent per quarter for over four consecutive quarters. Various asset-smoothing formulae applied by actuaries initially masked the extent of the drop in pension assets, however, and many pension plans were able to delay increasing contributions to eliminate their deficits for up to three years under the currently prevailing frequency for actuarial valuations. Both asset smoothing and delays in actuarial valuations effectively prolonged the pension funding crisis.

Opportunistically scheduled valuations and actuarial asset smoothing may involve good intentions by pension plan sponsors and actuaries. The understandable goal of both actions is to even out fluctuations in employer contribution rates, hence enabling the sponsor to plan cash flows better. The problem is that no one can accurately predict when financial markets will peak or bottom out, nor at what levels this will take place. All of the many different approaches to smoothing assets are thus inevitably flawed, promote lack of transparency, and may delay necessary responses to changes in financial markets. Overall, the result is that a three-year valuation cycle and asset smoothing frequently yield perverse results. We believe that the Commission should address these matters as follows:

Recommendation #6:

The frequency of actuarial valuations should not be changed at this time, but a study should be conducted regarding the incidence of opportunism in asset smoothing, and the consequences of that opportunism for plan members, pensioners and sponsors. The effects of phasing out of actuarial smoothing should also be studied.

* * *

Accounting rules now require the annual financial statements of pension trusts to include a note that updates the actuarial status of the pension plan to which the trust relates. Hence the OFSS receives (up to nine months in arrears) annual information about the financial health of pension plans, even though valuations are required only at three-year intervals. To prevent severe pension deficits from developing during the inter-valuation period of a plan, the OFSS should be empowered to intervene pre-emptively.

Recommendation #7:

The OFSS should be empowered to require a pension plan administrator to submit a new actuarial valuation as at the end of the most recent plan fiscal year of the plan if it has good reason to believe that the plan may be in significant deficit.

* * *

Rigid federal excess-surplus regulation ignores normal market cycles which predictably cause pension-plan surplus/deficit cycles. Recent Quebec pension legislation has spread out the burden of inevitable fund deficits by enabling employers to delay repayment of their pension fund deficits over ten years or more, or even allowing them to negotiate loan guarantees (or letters of credit) to cover such deficits. In Ontario, the legislation also attempts to deal with the fund deficit, by increasing pension contributions. In this case, the increased surpluses created by this legislation in good performance years will all be cancelled by the federal cap—no solution at all. The interaction at cross purposes of federal and provincial regulations tends to cause pension plans to incur ongoing deficits leavened with occasional relatively modest surpluses. The goal of regulation should be precisely the opposite: healthy pension plans with actuarial surpluses in most years, punctuated with occasional modest deficits.

It is axiomatic that persistent plan deficits endanger pension benefits, or – at the very least – create the perception among beneficiaries that benefits are endangered. They also have negative economic and psychological effects on plan sponsors, forcing them to consider alternative pension arrangements or plan windup. Pension fund trustees may see themselves compelled by deficits to immunize their portfolios, a "final solution" to short-term market fluctuations that not infrequently is advanced by investment consultants. Immunization predictably prevents any surplus from ever troubling the trustees in the future. Recurring plan surpluses, on the other hand, have the opposite effects. Plan sponsors may be persuaded to improve benefits if their DB pension plans enjoy surpluses, fund investment policies can aim at long-term success and plan members will feel comfortable with their pension arrangements.

***Recommendation #8*:**

If the Federal Government is unwilling to completely eliminate its 'going-concern' pension surplus cap, Ontario should make the strongest possible representations to the Federal Government to increase the flexibility of the CRA restrictions on pension surpluses.

One method would be to change the inflexible cap to a rolling multi-year formula which would reflect the ongoing investment performance cycles, a formula that would enable a pension fund to overshoot its surplus cap during highs in the investment performance cycles by balancing these 'excess' surpluses against undershooting of the cap in poor

years. Such a rolling formula would enable a pension fund to retain enough performance-related increased value in good economic years to offset the poor performance in bad years. An alternative method of achieving this necessary flexibility would be to move the cap at the top of allowable surplus higher, say to 20 or 30 %. Such increased flexibility would help minimize deficit problems of pension funds in poor investment years, such as we have recently experienced, and it would only minimally reduce federal tax revenues over each business cycle.

1.4 Pension Plan Surpluses: Partial or Complete Contribution Holidays [TOR #1 and #8]

Suspension or cessation of contributions to a pension fund is sanctioned by PBA Regulation 7(3):

> **In any year for which no special payments are required to be made for a pension plan under section 5, an actuarial gain may be applied to reduce contributions for normal costs required to be made by the employer, by a person or entity required to make contributions on behalf of the employer, by the members of the pension plan or by any of them. O. Reg. 116/06, s. 9 (2).**

Essentially, if a going-concern surplus is identified in an annual report to the OFSS, this regulation effectively permits a contribution holiday to be put in place by the plan sponsor without any notification to plan members or pensioners and without seeking permission from the OFSS. Other regulations appear to require little monitoring of the holiday, inasmuch as no interim reports are mandated, annual reports with respect to DB plans may be filed up to nine months after the end of the plan's fiscal year, and triennial valuations twelve months in arrears.

Experience over the last decade (cited above) has shown that many plan sponsors did not halt contribution holidays on a timely basis and resume normal contribution levels as surpluses were turning into deficits. In a very few cases this delay may have been wilful, in others it resulted from lags in perception of the changed environment, and lags in reaching and implementing decisions. This suggests that the surplus threshold for starting a contribution holiday is set too low and that monitoring of the effects of the holiday quite inadequate to prevent holidays from leading directly to future funding difficulties.

There is a further problem. During most contribution holidays, pensioners receive no increased benefit, while the plan sponsor – and in some cases, active plan members – gain financially through the reduction or cessation of contributions. Although going-concern surpluses can arise in many ways – for example, changed actuarial assumptions or method, reduced plan benefit provisions, mortality greater than projected, etc. – the major source of the surpluses that lead to contribution holidays is almost invariably the investment earnings in excess of the projected level on pension funds. Since a significant proportion of a mature plan's pension funds (in some cases as much as half) typically relates to retired members, it is unfair that pensioners seldom if ever share in the financial gain from the holiday. This unfairness can be rectified.

If these two problems were properly addressed through stricter regulatory control of contribution holidays, using a portion of a pension plan surplus through a partial or total contribution holiday would not be unreasonable. We urge that the following set of changes to the PBA and the PBA regulations be introduced:

***Recommendation #9*:**

Every defined benefit or hybrid pension plan in Ontario should be required to establish a *normal level of employer contributions*, which – given the 50% rule – could not be lower than the matching level. This would be the level at which, under the prevailing actuarial assumptions of mortality, rates of return, etc, the plan could expect to be fully funded over time, starting from a zero 'going-concern' surplus/deficit position.

A plan sponsor seeking to contribute less than this "normal level" should be required to submit to the OFSS for approval a proposal to that effect, together with an actuarial valuation and an estimate of surplus reduction projected to arise from the lower than normal contributions and from other benefits expected to be provided under the proposal.

Approval of the sponsor's proposal by the OFSS would require that

(a) the initial level of 'going concern' surplus measured at market values of assets be equal to at least 10% of plan liabilities,

(b) a share of the surplus reduction under the proposal be provided (as lump-sum non-pension benefits) to plan pensioners in proportion to the plan liabilities related to those pensioners, and

(c) the proposal provide that active plan members receive a share of the overall surplus reduction related to the ratio of employee contributions to total normal plan contributions (i.e., normal employer contributions plus normal employee contributions).

***Recommendation #10*:**

To avoid "overshooting," updates of the actuarial status of the plan be required to be reported promptly after quarter-end to the OFSS every quarter year during any contribution holiday. If such a report revealed that the Plan surplus was five percent of liabilities or less, the contribution holiday would terminate forthwith.

2.1 Indexation Issues - Effects of Indexation on a Plan's Funded Status: [TOR #3]

According to Professor Allen Goss at Ryerson University ("Can Professors Afford to Retire: A Survey of Canadian University Pension Plans," *Journal of Pension Economics and Finance*, 6:2 (July, 2007), three defined contribution pension plans exist at Ontario universities, one of which incorporates some indexation. Some indexation arrangement prevails at all seven Ontario universities with defined benefit pension plans. Similarly, each of the seven Ontario universities with hybrid pension plans has some provision for

indexation. These indexation arrangements vary considerably, but may be divided into three categories which may be combined with one another:

(a) those that determine indexation by a contractual formula alone (9 plans);

(b) those that link indexation to investment performance of the pension fund in excess of some threshold rate (5 plans); and

(c) those in which at least some indexation is at the discretion of the plan sponsor or administrator (1 plan).

Actuaries are permitted in some circumstances to use professional judgement, but generally must "conform to accepted actuarial practice." [Canadian Institute of Actuaries, "Consolidated Standards of Practice", May 2002, Section 1210. See also Section 1130.] Section 1730 ("Appropriate assumptions") of the Actuaries' manual makes it clear that actuarial going-concern and solvency calculations for pension funds should make assumptions that take account of the plan's indexation provisions.

As we understand "accepted actuarial practice," the mechanisms for prefunding contractual and linked indexation differ. Formulaic (contractual) indexation would require (1) an estimate of the rate of inflation anticipated over the next three years, (2) a calculation of the resultant amounts of incremental pension payments expected under the formula, and (3) application of these amounts in the calculation of current service costs of the pension plan. Linked indexation generally would require an assumed post-retirement rate of return for the pension plan that is lower than the assumed pre-retirement rate (e.g., 4.5% instead of 7%, for 2.5% spread). In effect, this would increase the plan's actuarial liability for current and future pensions, funding indexation by the same percentage point spread when fund returns just match the assumed pre-retirement level. If the pension fund's rate of return exceeds the pre-retirement rate, more indexation is available; if the rate of return falls short of the lower post-retirement rate, all indexation is postponed until this shortfall is made good.

In provinces other than Ontario, the only implication of linked indexation for a pension plan's funded status would be that some fluctuations in investment results are being absorbed by variations in indexation, implying that pensioners are bearing a portion of the investment risk of the pension fund. In Ontario, however, the regulatory environment with respect to inflation protection can best be described as hostile. Ontario PBA Regulation #11(1) provides that

> **The estimated future costs of the escalated adjustments of a pension plan that provides for escalated adjustments may be excluded from the funding requirements set out in sections 4, 5 and 6. R.R.O. 1990, Reg. 909, s. 11 (1).**

Consequently Ontario regulation and actuarial practice are in conflict, producing the confusing situation where some going-concern actuarial valuations in Ontario include prefunding of both contractual indexation and linked indexation, while others do not. We regard this situation as unacceptable and discriminatory. If a defined benefit pension plan contains provisions for indexation – whether contractual or linked, those benefits should be prefunded, just as bridging benefits, early-retirement benefits, minimal spousal benefits, and other ancillary benefits are prefunded.

***Recommendation #11*:**

The PBA regulations should be amended to ensure that the estimated future costs of contractual indexation and of linked indexation provisions in Ontario pension plans are always included in the funding requirements of those plans.

* * *

At least three other aspects of Ontario pension regulation in respect of inflation protection are also seriously deficient. First, the PBA regulations [Regulation # 1(2)] require the exclusion of contractual and linked inflation protection provisions from solvency liabilities. We discuss this below under Wind-up. Second, PBA Regulation 10 appears to exclude use of surplus to fund linked indexation, as well as to deny employees, unions or pensioners any say regarding the form of indexation. Third, section 53 of the PBA ("Inflation Protection") is unclear, but might cynically be interpreted to mean that no contractual inflation protection of pension benefits in Ontario enjoys any legal protection. Possibly such an interpretation should be extended to linked indexation, as well.

Ontarians expect better from their government. Although inflation is relatively benign at the present time, even the federal norm of 2 % annually, compounded, suggests that the occupational pensions of current and future retirees will lose a significant amount of purchasing power over their remaining years. The Canada Pension is fully linked to inflation, as is OAS, but for many seniors, occupational pensions are more important than these two other sources of retirement income. What possible advantage do Ontarians who are active plan members, pensioners or even plan sponsors derive from legislation the lack of clarity of which begets litigation?

Recommendation #12:

PBA Regulation 10 should explicitly permit use of surplus to fund performance-linked indexation, and it should permit and encourage employees, unions and pensioners to be involved in determining the form of indexation.

***Recommendation #13*:**

Section 53 of the PBA should be amended to make it permissive. It should encourage incorporation of indexation provisions in pension plans, rather than mandating particular methods of indexation. Furthermore, Section 53 of the PBA should at a minimum require every DB and hybrid pension plan under its jurisdiction that has been in operation for a decade or longer to allocate at least 0.5 % of its assets annually to provide indexation to its retired pensioners (and their surviving spouses) using a systematic and fair method approved by the OFSS.

This "tax" on DB pension plans would suffice to provide about 1.5% indexation to pensioners, since about one third of the liabilities of a mature plan relate to pensioners. Note that this recommendation would ensure some minimal funding for indexation over time without specifying the indexation method to be used.

2.2 Pension Plan Surpluses: Distribution on Wind-up [TOR #7 and #11]

Ontarians whose pension plans provide partial or complete indexation should be very concerned about the negative potential of a wind-up. Not only does the PBA not protect their interests effectively, Regulation # 1(2) reduces their entitlements by excluding inflation protection provisions in their pension contracts from the calculation of solvency liabilities. In other words, some of the pension promises that have been agreed between plan sponsors and plan members and former members can simply be ignored, if the sponsor decides on a partial or complete plan wind-up. Not only does this regulation appear to conflict with the normal applications of contract law; it may also be inconsistent with trust law. No wonder that litigation develops in wind-up situations in the Province.

It might be countered that calculations of future rates of inflation, future rates or return and other future contingencies is too difficult. But actuaries make assumptions about future events all the time; that is a major part of their professional responsibilities. [Canadian Institute of Actuaries, *Consolidated Standards of Practice*, May 2002, Section 1710 ("Needed assumptions"] This assertion therefore has no merit.

The normal wind-up process of purchasing annuities puts indexed pensions immediately at risk because most annuities incorporate no escalator provisions, whether linked to performance or based on rates of inflation. Two possible solutions to this problem involve changing the wind-up process fundamentally:

(a) to permit the pensioners as group to take over the pension fund to be wound up, and to continue to administer the deferred pensions and pensions-in-pay by selecting trustees of their own choosing, or

(b) to transfer both the assets and the liabilities of the pension fund being wound up to a public-sector investment fund for Ontario established as described in R*ecommendation #2* above. Essentially this process would be analogous to the takeover of a small troubled bank by a larger, better capitalized one, like the experience a generation ago with the Unity Bank and the Continental Bank.

Recommendation #14:

Alter Regulation 1(2) to include "escalator provisions" in the calculation of solvency liabilities, and make any other required regulatory changes to ensure that indexation provisions are fully taken into account in plan wind-ups.

***Recommendation #15*:**

Give serious consideration to permitting pensioners and deferred pensioners of plans wound up the right to administer their own DB pension funds, subject, of course to regulatory restrictions.

***Recommendation #16*:**

Extend the mandate of a voluntary public-sector investment fund for Ontario (see *Recommendation #3* above) to include the administration of pension funds that are being wound up.

2.3 Pension Plan Surpluses: Distribution from Continuing Plan [TOR #7 and #11]

In Ontario, distribution to the employer of surplus that has arisen over the past two decades requires the text of the plan to have contained explicit wording permitting such an action as of December 31, 1986. Furthermore, in a continuing plan, only the surplus that exceeds 25% of liabilities may be distributed to the employer. Effectively, these rules so tightly restrict direct withdrawal of surplus from a continuing plan that the indirect approach of taking a contribution holiday is used by plan sponsors instead. In our view, these are reasonable constraints on dissipation of pension surpluses.

Recommendation #17:

The PBA's currently prevailing restrictions on surplus withdrawal by employers should continue.

3.1 Effective Involvement by all Plan Members in the Governance of Pension Plans and Pension Funds. [TOR #18]

Section 24 of the PBA provides for the establishment of an advisory committee of active and retired plan members for any Ontario pension plan. To implement this provision, however, requires a majority vote, which superficially may appear reasonable, but is not. First, the plan sponsor may fail to cooperate in the voting process. Then, many of those entitled to a small deferred pension may be impossible to locate; pensioners who are aged may no longer be mentally competent; everyone must vote individually, even if represented by a union. Retirees are particularly disadvantaged because they may live at a distance from their former work location and their addresses will not be revealed by the employer for privacy reasons. Furthermore, they are entitled to share only one representative on the committee with deferred pensioners; whereas active plan members may have several representatives.

Even if these difficulties are overcome, and a committee is established, its real powers are very limited. It may examine the pension plan's and pension fund's records, monitor the plan's administration and make complaints to the plan's administrator. The committee cannot prevent adverse amendments from being advanced or implemented by the plan sponsor, it cannot grieve misinterpretation of plan provisions by the plan administrator or administration of the plan that is inconsistent with the plan's terms, it has no power to approach the OFSS with its concerns.

Effective governance at all levels is crucial to the management and the performance of pension plans. Good governance ensures fiduciary responsibility both in plan administration and pension fund management. It promotes accountability and transparency. Unfortunately, many pension plans lack proper governance in one or more dimensions. For example, the Rotman International Centre for Pension Management Study (Toronto, ICPM, 2007) compared 2006 to l996 survey data and found that inadequate selection procedures and the weak competence of some board members

were continuing problems. These problems have a direct impact on pension plan performance. Weak governance begets weak performance.

Recommendation #18:

The rules for advisory committees should be revised to make them easier to establish and give them greater powers to intervene. Consideration should be given to establishing a Provincial Pension Ombudsman who can be addressed concerning perceived deficiencies in DB pension administration.

Recommendation #19:

The PBA should require that pension administrators regularly disclose what steps they are implementing to improve governance by means of (a) developing templates for ideal board selection and membership, (b) initiating effective self-evaluation processes for boards, (c) clarifying the roles of various participants, (d) adopting high-performance cultures, and (e) eliminating the 'competing financial interests' syndrome of differing stakeholders.

3.2 Making Pension Plans more transparent to Plan Members [TOR #17 & #18]

Transparency results from good communications and appropriate reporting mechanisms. But pensioners and plan members may not understand actuarial calculations, and they may find pension terminology mysterious. So communication of pension information to plan members and former members is difficult. Moreover, despite legislative requirements for disclosure in the Pensions Benefits Act, [sections 25-30], the information required to be disclosed is insufficient for concerned employees and retirees. The result is an erosion of confidence in pension fund trustees and administrators. Quarterly and annual reports and pension meetings for the plan members are only as effective as the administrators and managers wish to make them. With the increasing sophistication of software and the accessibility of electronic communication, general pension plan information, detailed documentation and simulation of the effects of choosing various pension options should readily be available on the plan sponsor's websites.

In addition, the OFSS should require greater disclosure of information about pension fund investments, investment policies and the structure of the pension plan assets and liabilities. Items to be communicated should include: a) the plan's accrual patterns; b) the plan's funding policy – both target level of assets and contribution strategies; c) the plan's provisions regarding distribution of surplus; d) responsibility for actuarial deficits; e) the annual administrative costs of the pension plan and the breakdown of these costs; f) investment policies of the pension fund's trustees; and g) quarterly investment performance reports from the fund's investment managers.

Recommendation #20:

The OPBA should require regular reporting through electronic and other channels by the pension plan's administrator to active plan members and pensioners on those items listed above and other relevant important information.

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We hope that we have clarified some significant issues relevant to your Terms of Reference--and to retirees. We are prepared to answer questions on the above points at the Hearings. Many thanks for your efforts to resolve these complex and important issues.

Emeritus Professor John Meyer

Chair, CURAC Standing Pension Committee.