Pension Investment Association of Canada
Association canadienne des gestionnaires de caisses de retraite

PIAC Response to Ontario Expert Commission on Pensions

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Executive Summary

The Pension Investment Association of Canada (PIAC) is pleased to have the opportunity to contribute to the review of Ontario's pension system by the Ontario Expert Commission on Pensions.

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over $910 billion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

In establishing the Expert Commission ("Commission") on Pensions, the Ontario government articulated a set of guiding principles and PIAC shares a belief in these core values:

- the importance of maintaining and encouraging the system of defined benefit pension plans in Ontario
- the importance of maintaining the affordability of defined benefit pension plans for both members and sponsors
- the importance of pension plans in supporting a competitive economy
- the need to safeguard the security of pension benefits
- the need to balance the rights and obligations of employers, plan members and pensioners.

PIAC applauds the initiative of the Ontario government in commissioning an expert review of the pension system in Ontario. The *Pension Benefits Act* (PBA) is outdated and clearly in need of an overhaul. The management of pension plans has changed radically in the two decades since the last major review of this legislation. Capital markets have changed dramatically with the introduction of more and more sophisticated investment tools such as derivatives and hedge funds, the increased pace and use of technology/electronic trading and the impact of globalization and increased economic competition. The pension system today is facing enormous challenges arising from an aging population, low interest rates, market volatility, rising governance standards and stakeholder expectations, regulatory burdens and the evolution of case law.

PIAC shares the Commission's concern that defined benefit plans may significantly decline, not only in Ontario, but across Canada. Defined benefit ("DB") pensions deliver cost-effective pensions to retirees. DB pension plans pool both longevity and investment risk and address inflation risk if indexed. Yet, DB pension plans are becoming less and less a feature of Canada's pension system, especially in the private sector. Overall coverage of paid workers in Canada by registered pension plans declined from 46.2% in 1977 to 39.3% in 2003. The decline in DB pension plans was more pronounced, with the percentage of plan members in a DB pension plan declining from 92.7% to 81.5% over the same period while for private sector workers alone the decline was even greater, from 90.6% to 74.2%[1]

PIAC believes that the fundamental reason DB pension plans are declining is due to funding and regulatory challenges. Plan sponsors are experiencing increasing financial pressures from the volatility of pension expense due to ever changing equity markets and interest rates, and changes in accounting standards. Recent court decisions regarding partial windups, expenses, asset transfers and surplus (Stelco, Kerry, Transamerica and Monsanto) have created an uncertain and negative legal environment for plan sponsors. The pivotal Supreme Court ruling in the Monsanto case exacerbated the asymmetrical sharing of pension risk between employer and employee groups. Adding to this burden are the onerous and sometimes unnecessary requirements for funding solvency deficits over five years. Plans operating in multiple jurisdictions must also contend with the labyrinth of pension law and regulators across the country. This makes plan administration more difficult and costly. Finally, employees, especially younger ones, are not always aware of the benefits of defined benefit plans. All of the above mentioned points encourage plan sponsors to freeze or terminate their existing DB pension plans, and do not encourage plan sponsors to create new defined benefit plans.

While the situation may sound dire, solutions are at hand. Governments have the ability to alter the policy underpinnings of the pension regime and thereby alleviate some of the funding and regulatory challenges that plan sponsors and administrators are facing. In this submission, PIAC is recommending that Ontario:

1. Address risk asymmetry in the rules regarding surplus entitlement.

2. Take steps to ease solvency funding requirements by:
   (a) exempting all public sector plans from solvency funding requirements due to their low probability of default;
   (b) providing non-public sector plan sponsors the flexibility to use Letters of Credit; and
   (c) researching the feasibility of allowing non-public sector pension plans to have reduced solvency funding requirements based on their credit worthiness.

3. Facilitate the opportunity for plan sponsors to enhance the funded position of the plans when plan sponsors are able to do so by:
   (a) encouraging the Federal Government to amend the *Income Tax Act* to allow plan sponsors to make contributions beyond the current 110% limit; and
   (b) allowing plan sponsors to earmark contingency reserves to fund pension plans, where plan sponsors would have the clear entitlement to reclaim funds not required to fund pension benefits.

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[1] B. Baldwin, "Determinants of the Evolution of Workplace Pension Plans in Canada", March 2007.

4. Hold pension investments to the standard of a prudent person and eliminate all quantitative limits on investing.

5. Clarify the rules In the case of a merger, split, restructuring or partial wind up to provide that only liabilities are required to be transferred and not the surplus.

6. Harmonize pension law across Canada.

7. Establish one regulatory system for pensions with one set of rules.

8. Disband the Pension Benefits Guarantee Fund.

It is time for the Ontario government to amend the *Pension Benefits Act*. Defined benefit plans have not declined as much in Canada as in other nations such as the US, U.K. and Australia. Before the trend accelerates, the policy approach to funding rules and other regulatory issues needs to change significantly. The changes that PIAC is recommending will create a more conducive environment for creation and maintenance of DB pension plans, while levelling the playing field with DC pension plans. The Commission and the Ontario government have an opportunity to demonstrate leadership in this area.

Response to Questions Posed by the Ontario Expert Commission on Pensions

1.1 To what extent do occupational pension plans — especially defined benefit plans — contribute to the overall provision of income security for Ontario's older workers?

DB pension plans provide a valued source of retirement income in addition to government pension plans (e.g. CPP/OAS), and personal savings.

1.2 To what extent do these plans presently meet the needs and expectations of their members and sponsors?

One of the key findings in Towers Perrin's 2006 *Survey on Pension Challenges and Changes* was that "retirement programs remain an integral part of the overall rewards strategy in Canada today. A majority of respondents feel their retirement programs are necessary to ensure that their organizations provide a competitive total compensation offering, even if many appear to be struggling to reconcile traditions of providing generous retirement benefits with current business challenges and changing workforce needs." DB pension plans protect employees the best by managing investment and longevity risk for them. However, employers bear these risks over the long term, along with pension governance risks, pension expense volatility and administrative complexity. DC pension plans pass the investment and longevity risks on to employees, and the employer retains the governance risks and administrative role.

1.3 How well have these plans been managed in recent years, and how might their management be improved?

The health of pension plans has been improving steadily over the past few years, and according to the Mercer Pension Health Index the funded position was close to 90% at the end of June 2007, the highest point in four years. However, the index dropped to 85% in mid-August, but was still higher than it was at the start of 2007 (84%).

The combination of rising stock markets and a modest increase in bond yields is largely responsible for this improvement. A portion of the improvement can be attributed to increased contributions by plan sponsors.

It should be noted, however, that volatility remains. The issue is managing a long-term entity in a short-term regulatory world.

1.4 Why has coverage by defined benefit plans decreased? Why are few, if any, new defined benefit plans being established?

PIAC believes the following are contributing factors:

- Uncertainty over ownership of surplus
- Solvency Funding requirements over a short period
- Pension expense volatility (particularly for corporate plans)

- Difficulties with employee appreciation and understanding of DB pension plans
- Growing legal risks and issues
- Changing employee attitudes in favour of individual savings

1.5 In light of recent court decisions, are appropriate legal rules in place to protect the interests of present and prospective pensioners, and of employers who sponsor plans?

No. The current legal rules are unclear for all parties and have been interpreted differently by practitioners, the Financial Services Tribunal (FST) and the Courts through time. A troubling example is the Monsanto case where the employer's entitlement to surplus was generally well accepted by practitioners until the FST made a surprise ruling (inconsistent with previous guidance), which was subsequently upheld by the Supreme Court of Canada. That has now increased the asymmetrical sharing of pension risk between plan sponsor and beneficiary which is contributing to the deterioration of DB plans generally. The decision may also impact beneficiaries as more plan sponsors take steps to ensure that plans are not over funded, which reduces pension security.

Other cases include Stelco, Kerry, and TransAmerica which have each added uncertainty around partial windups, expenses paid from plans and asset transfers respectively. The combination of all four cases creates a serious litigation risk for all DB plan sponsors in Ontario who have gone through a downsizing in the face of economic pressures. Plan sponsors will continue to move away from DB plans in an environment which is so uncertain and seemingly hostile. Present and prospective pensioners are ill served if the continued uncertainty leads to further reduction in DB plans.

1.6 Are appropriate oversight mechanisms available to ensure compliance with the legal rules?

Yes. Plan participants are able to access important information from FSCO or to seek it directly from the plan sponsor, if necessary. FSCO will assist if the plan sponsor is unresponsive. However, the reporting of guidelines and compliance certification could be enhanced and made available to members online.

1.7 Should different kinds of workers, employers and plans be subject to different regimes of regulation?

In general, PIAC believes that all plans should be subject to the same rules. However, where certain differences are prescribed, care needs to be taken to ensure that the different approach is warranted and appropriate at the broad policy level and that the differentiation does not disadvantage one type of plan over another. For example, rules pertaining to the funding of solvency deficits could differ based on the credit worthiness of the plan sponsor. In the banking sector, banks provide loans based on the creditworthiness of borrowers.

1.8 How much importance should be attached to the harmonization with the law of other Canadian jurisdictions?

Multinational employers face huge administrative complexities under the current system and this is driving plan sponsors, among other reasons, away from defined benefit plans. Full harmonization in Canada is long overdue and we believe it is time for Canada to consider one regulatory system with one set of rules.

1.9 What are the overall effects of the present system of occupational pension plans on Ontario's social policies and economy?

The cost of investment management outside of a DB pension plan is extremely high, as mutual fund fees in Canada are the highest in the industrialized world. High management fees to deliver on average market returns net of fees will significantly reduce incomes in retirement, leaving many short of their expected future living standards.

Outside of CPP, which aims to replace a very modest percentage of pre-retirement income, there is very little public policy that attempts to ensure that the maximum number of people are adequately provided for in retirement.

With dependency ratios expected to rise dramatically in the next 20 years, fiscal strain could become very large if the state feels political pressure to supplement incomes of a large number of seniors. This strain will be felt provincially and federally, and could seriously constrain the health and education budget and expose the economy to a larger than expected tax burden.

Public policy in Canada and Ontario is seriously deficient with respect to enabling employees and their employers to accumulate savings that are sufficiently adequate to meet future needs, and also fall far short of encouraging sufficient competition in the provision of asset management services and market access at reasonable cost. This policy inadequacy could have far reaching and negative effects on the economy and its ability to sustain future social programs at today's levels.

2.1 How have long-term changes in the structure of Ontario's economy, in its labour market and social welfare policies, and in patterns of employment, unionization and compensation affected occupational pension plans?

DB pension plans have come under significant pressure since they have produced a liability that companies would rather not, or cannot, bear. Greater global competition from low-cost suppliers has accelerated this trend.

The conversion from DB to DC pension plans transfers the liability of insufficient asset growth to the individual from plan sponsors.

While this might make the economy more flexible and able to adjust more rapidly to global competition, it can also render many with insufficient savings in retirement as individuals tend to underestimate their future savings needs to maintain a reasonably comfortable retirement and thus save too little.

2.2 How will longer life expectancies and the end of mandatory retirement affect such plans?

Longer life expectancies will make the cost of DB plans more expensive. Plan sponsors should be using the most up to date mortality tables to calculate their liabilities. Mandatory retirement has had no material cost implications in other provinces.

2.3 Is the ratio of retirees to active members of occupational pension plans changing, and, if so, why? What are the effects of such changes on these plans?

The ratio of retirees to active members in DB plans is increasing, for the following reasons:

- Many sponsors have closed DB plans to newer employees, instead offering them a DC plan. This makes the DB plan more mature as existing members grow older.
- When sponsors divest parts of the business, they transfer only the liabilities related to active employees in the units being divested, whereas obligations related to retirees are retained. This adds to the increased maturity level of the plan.

As such, fluctuations in the cost of a maturing DB plan can have a significant impact on the operating results of the sponsor.

2.4 How have recent fluctuations in investment returns and long-term interest rates affected defined benefit plans in particular?

A long-term trend in declining interest rates and negative equity markets at the beginning of this decade caused many DB plans to be underfunded. More recently, there is a gradual reversal of this trend, partly due to increased contributions, increasing long-term interest rates and strong market returns. However the markets remain volatile.

2.5 Are such fluctuations likely to accelerate or decelerate in the future? Can new tendencies be identified that might affect these plans positively or negatively?

It is difficult to forecast changes in interest rates, equity returns, and inflation rates. Volatility is certain.

2.6 How might changes in the viability, coverage, cost and funded status of occupational pension plans affect the prosperity, security and well-being of Ontario workers and pensioners?

PIAC supports increased pension coverage. In the private sector, there is a shift towards higher cost DC plans or no plans, which transfers the responsibility for retirement planning away from employers and to individuals. In this case, there will be a need for more financial planning education, ideally beginning in grade school. Unfortunately, the trends may result in fewer workers saving for retirement and this may lead to greater need for income support for seniors from taxpayers in future.

2.7 What has been the impact of inflation on pensioners and pension plans? How common is the indexation of pension benefits?

Although inflation has been very low for years, the cumulative impact of inflation has significantly reduced the purchasing power of non-indexed pension income. Outside of public sector plans, indexation is not common. Some plans offer ad-hoc indexation. Increases are tied to the funded status of the plan. For example, increases may not be contemplated if the solvency funded status is below 100%.

2.8 How does the health of occupational pension plans affect the robustness of the Ontario economy and the success of Ontario businesses? How might their health affect different workplace constituencies such as public and private sector employers, large and small enterprises and unionized and nonunionised workforces with different demographic profiles located in various work settings?

Both the Ontario and Canadian economies are more robust with healthy occupational pension plans. Pension plans provide a significant amount of capital to invest in global markets. When occupational pension plans are healthy, contribution rates can be kept at reasonable levels, and future annuitants and the sponsoring entities can have a degree of confidence that the pension promise can be kept.

Public sector plans are in a far better position than private sector entities to deliver on the pension promise – because governments have the power to tax in order to fund deficits, albeit at the expense of other spending initiatives such as health, education, infrastructure, etc. This could, at the margin, give the public sector a labour market compensation edge if they are able to offer a DB pension that replaces a good proportion of pre-retirement income with a high degree of certainty.

2.9 Are changes in the structure and governance of occupational pension plans likely to affect their administration and financial well-being, and if so, how?

Pension plans, in general, have a potential governance issue with non-expert pension boards and reliance on third-party suppliers (agency risks) where interests are not closely aligned. These non-expert Boards rely on third parties that have no real accountability or vested interest in the outcomes of actions on which they are providing “advice”. In most instances, third parties refuse to provide advice for fear of assuming liability for their advice. Instead they provide options for the Board to consider. An effective pension board and governance structure is required to provide effective oversight of staff and/or third party providers. Capable internal staff who are incented to act in the best interests of the beneficiaries is key.

Keith Ambachtsheer, in his book *The Pension Revolution*, suggests that pension plans "must be run by co-ops that operate at arms-length with sponsors and product providers and employ internal experts in pension management. Only this type of delivery arrangement has a reasonable chance of overcoming the inherent conflicts and high costs many pension plan sponsors and the for-profit financial services industry bring to the table."

3.1 What role are occupational pension plans, especially defined benefit plans, likely to play in the array of strategies which will provide economic security for future generations of older Ontarians?

In the absence of changing the environment in which pension plans are managed, DB plans are in danger of being gradually phased out, at least in the private sector. Changes to regulatory and tax environment are needed that would motivate sponsors to implement DB plans and increase contributions. As well, the suggestions mentioned above, such as expert boards, pooling of assets to reduce administrative costs, would help.

3.2 Will these strategies, in combination, provide all retired Ontarians with a measure of equity and security?

Pension plans are not mandatory so unless governments make pension plans mandatory for all Ontarians, there is no guarantee that employers will offer a pension plan for all employees. However, PIAC's recommended changes will help improve the current situation.

3.3 What can be done to strengthen the role of occupational pension plans in the short term? In the longer term?

Clarify surplus ownership, eliminate or ease solvency funding rules for plan sponsors who can demonstrate strong creditworthiness, raise the Income Tax Limit from 110% of liabilities and allow the use of Letters of Credit and/or "earmarked contingency funds" for plan sponsors to fund deficits.

3.4 What degree of latitude or encouragement should Ontario pension law and policy provide for plans other than conventional single-employer plans? Should it actively encourage the formation of larger, more sophisticated sectoral, multi-employer, jointly sponsored or cooperative plans? Should other experimental designs be accommodated under the Pension Benefits Act and, if so, subject to what conditions and controls?

If employers wish to pool assets, participating employers will have to agree to common elements associated with plan design that their organization can tolerate. A governance structure will need to be put in place that allows representatives from these organizations or their “expert” delegates to oversee the plan that they are sponsoring. As stated earlier, Keith Ambachtsheer advocates the notion of pension co-ops that employ internal experts.

4.1 What are the unique attractions of defined benefit plans? What special problems are associated with them?

Attraction: Retiree is protected from interest rate risk, inflation (only if indexed), conversion risk, and longevity risk, assuming the retiree lives well past retirement.

Problem for plan member: Intergenerational inequity. All plan members do not get the same benefit for the cost paid.

Problem for employer: Expense volatility, risk of deficit/underfunding, and potential loss of surplus.

4.2 Will fluctuations in unionization rates and in levels of public-sector employment affect the extent of their coverage and their financial viability in general and in different sectors?

Very likely. Unionized environments are pro DB plans and most public sector workers are in DB plans.

4.3 What is the effect of employer business strategies on the form of pension provision? What is the impact of privatization, mergers, acquisitions and bankruptcies on defined benefit plans?

PIAC believes business change activities such as these will cause a shift from DB to either DC or to no pension if no changes are made to the status quo.

4.4 To what extent should public policy promote and protect defined benefit plans because of their attractions? To what extent can changes in public policy and legislation reduce or eliminate the perceived shortcomings of defined benefit DB plans to encourage their wider adoption?

Public policy should promote a strong retirement system. Employer sponsored pension plans (DB or DC) are a valued source of retirement savings. However, from the employer perspective, the delivery of pension plans need to be cost effective and fair. The following shortcomings need to be addressed: risk asymmetry/surplus ownership, ITA limits, solvency funding, agency costs, non-expert pension boards, non-harmonized pension legislation, etc.

4.5 Should indexation of defined benefit plans to offset inflation be left to the discretion of the plan sponsor, subject to collective bargaining in the case of unionized workplaces?

Yes because there are many trade-offs involved. Indexation is one of many features that may be attractive to plan members. There is a cost associated with indexation that may be traded off for other elements of the overall total compensation package provided by an employer.

4.6 To what extent should public policy encourage experiments with new varieties of occupational pension plans (such as cash balance plans that are widely used in other countries) or with alternative types of income security plans designed to deliver retirement benefits to workers comparable to those provided by conventional defined benefit plans?

The regulatory system should allow new types of plans to develop.

4.7 Should Ontario compile and publish materials that might enable members and sponsors to make more informed choices among different types of plan design and strategy?

This may help. While the primary responsibility rests with plan sponsors, there is a broader role for the government to educate Ontarians on general pension matters.

4.8 Would joint administration of defined benefit plans, or other changes in their structure and governance, make them more attractive to employers or less?

Employers are attracted to cost-effective solutions that are fair deals and have good governance structures. As long as this is achieved, employers will consider all options.

5.1 Are existing definitions of plan "solvency" realistic?

No. Existing rules for funding solvency deficits are too stringent. Funding requirements require solvency deficits to be eliminated over 5 years. The deficit is based on a point in time calculation done at least once every 3 years. Managing a pension plan for the long-term becomes a short-term exercise. We recommend that research should be undertaken to consider the appropriateness and practicality of using the creditworthiness of the plan sponsor to determine solvency payment requirements.

5.2 Are the consequences of over or underfunding for employers, workers and pensioners fair, clearly stipulated, well understood and appropriately enforced?

Employers clearly understand the risks of over funding. In light of the Monsanto decision, employers are not encouraged to over fund if they do not have access to surplus generated as a result of the over funding. Employees understand the benefits of over funding as evidenced by claims on surplus. In general, both employers and employees need to have a better understanding of the true costs of pensions and work together to ensure a fair deal for both employers and employees.

5.3 Is there a necessary connection between underfunding and overfunding? If so, what does that connection mean for how the rules should address both situations?

Yes. Both are temporary at any one point in time. In order to grow pension funds to pay for current and future pensions and maintain manageable contributions, pension funds invest in riskier investments e.g. equities. The market value of equities will fluctuate over the short term. But over the long term, equities are expected to outperform bonds because of the risk assumed in investing in equities. A pension plan invested in 60% equities and 40% fixed income can expect their funded level to fluctuate between 80% and 120% in any one year, assuming a starting position of 100%. Rules need to take into account the long-term horizon of pension plans.

5.4 Should the pension regulator have wider powers to address funding concerns? If so, should these be discretionary powers?

The regulations need to be sound and flexible, and consistent for all types of plans that have similar credit qualities. Regulators should be given some discretion to deal with unique situations but care should be taken to prevent unfunded situations from becoming even worse. But consistent treatment by all regulators is required. The need for a single pension regulatory system is key.

5.5 Should different rules apply to different kinds of plans and different kinds of employers? If so, what distinctions would be appropriate and why?

See response to 1.7.

5.6 Should relief be provided against present solvency funding requirements, and if so, to which types of pension plans, in which sectors, and under what conditions?

See response to 1.7.

5.7 Should the sponsoring employer's financial strength be taken into account? And if so, to what extent and by what means?

Creditworthiness or the ability to pay debts including pension obligations is key. Plan sponsors' creditworthiness is or can be rated by independent credit rating agencies such as Standard & Poors, Moody's, etc. Alternatively, banks will take into consideration a plan sponsor's level of creditworthiness before extending a Letter of Credit to a plan sponsor.

5.8 What types of measures might be made available to employers to enable them to deal with funding deficiencies that seem likely to be short-term?

Obtain a Letter of Credit from the Bank. The bank will assess the creditworthiness of the plan sponsor before it agrees to advance funds.

6.1 Should Ontario urge the federal government to amend the Income Tax Act to allow plan sponsors to make extra contributions to the plan from time to time to keep it solvent over the long term?

Yes. Ontario needs to urge the federal government to remove the limit on making contributions. However, this initiative only makes sense if the uncertainty surrounding surplus ownership is addressed. Regardless of the ITA limit, plan sponsors will not add to surplus if they do not have a right to this surplus.

6.2 Should plan sponsors be given greater latitude to increase contributions or reduce benefits under carefully specified conditions?

It makes sense to contribute to a plan when contributions are tax deductible, the contributor's right to surplus is addressed, and contribution levels are tolerable. In the case of pension plans where contributions are shared (e.g. 50%/50% between plan members and the employer), plan members will reach a "pain threshold" once contributions to their pension plans are interfering with money they need to pay their mortgages, the children's education, etc. If contribution rates need to be increased for a short period of time e.g. 3 years, benefits will have to be decreased if plan members cannot afford the temporary increase in contributions that are required.

6.3 Should public policy encourage some other approach to the possible loss of plan solvency, such as mandating the establishment of earmarked contingency reserves?

Earmarked contingency funds are a good idea as long as the plan sponsor who contributes into the contingency fund has a right to the excess funds if not required to fund solvency. Surplus ownership rights need to be fair.

6.4 If a plan sponsor decides to pursue riskier investment strategies to deal with solvency concerns, should this decision be required to be taken according to some special procedures, or made subject to more intensive oversight?

See response to 1.7. If a plan sponsor can demonstrate a strong level of creditworthiness, the plan sponsor should not be subject to any additional rules. Investment strategies are long-term in nature. A long-time horizon is required to withstand the volatility of certain asset classes. Provincial regulators should focus on the least credit worthy plan sponsors. In the worst case scenario in which the plan sponsor cannot obtain funds or a Letter of Credit to help fund the solvency deficiency, the regulator and the plan sponsor will need to agree on a work out plan. More intensive oversight will be required. This plan may require a more conservative investment strategy and/or benefit reductions. However, each situation will be unique.

6.5 What effect might changes in the investment strategies of pension plans, and in the rules governing investment strategies, have on capital markets in Ontario?

One cannot think of capital markets as having a provincial dimension – they are global. Canadian dollar denominated assets are substitutable for any other asset in a global pool of liquidity. A greater opportunity set of investments leads to a higher probability of increased risk-adjusted returns.

The greater range of investment options and strategies that are available, the more diversification can reduce risk, and the greater the opportunity we have to ensure that the sum of diversified returns are greater than would be available from a more restrictive opportunity set.

Governments have influenced these strategies in the past by, for example, limiting the foreign content in pension plans. PIAC believes that the industry has evolved to the point that Canadian pension funds should be governed by the prudent person rule, which enables pension plan administrators to make the best investment choices for their plan. Canada is the only developed country that uses quantitative limits to the degree outlined in the PBSA, instead of the more universally applied prudent person standards for investing. Studies have consistently shown that such restrictions, by limiting the pool of available assets, have a negative impact on pension fund performance. More detail is provided in *Recommendations for Modifications to Pension Plan Investment Rules* submitted to CAPSA in August 2001.

The elimination of the 30% foreign content rule now allows Canadian pension plan sponsors to better manage the risk of their investment portfolios by allowing increased diversification of assets outside of Canada. However, the 10% single issuer rule restricts investments in such liquid assets as US Treasury bonds and other similar bonds of US government agencies. While PIAC believes that all quantitative limits should be eliminated, an immediate exemption should be made from the 10% issuer rule for US Treasury bonds and bonds of US government agencies, similar to the exemption currently provided for Canadian bonds issued by Canadian government issuers.

PIAC also recommends the elimination of the rules restricting a pension plan to electing no more than 30% of the directors of a company, even though it may own more than 30% of the equity.

Finally, PIAC recommends the elimination or increase of the 10% upper limit on accumulated surpluses in the Income Tax Act. This would help to remove a current disincentive for plan sponsors to contribute to pension plans when they are able to contribute.

7.1 Are the present rules concerning premiums, eligibility for protection and levels of protection appropriate? If not, how might these be changed in the longer term?

The insurance fund should be disbanded. It encourages plan sponsors to take undue risk with their pension plans. The existence of the PBGF provides an alternative to plan sponsors who cannot pay pensions. Ontario is the only province that has such a plan.

A similar plan exists in the US. However, in both cases, the insurance plans are under funded because of outstanding claims and represent potential liabilities to taxpayers, i.e., taxpayers will be funding pensions for the minority of taxpayers who are in DB plans.

7.2 Is the PBGF adequate to meet foreseeable claims on it under existing eligibility rules? If not, should the existing rules be changed? Should the PBGF be more appropriately funded?

See our response to 7.1. Adequacy is unknown because we can't predict future interest rate levels nor how equity markets are going to behave in the future.

7.3 Is a guarantee fund, such as the PBGF, the most appropriate way to protect the interests of plan members and pensioners from the effect of plan under funding of the employer's insolvency? If not, what are the alternatives?

No. See response to 7.1. Alternatives that should be explored include the requirement to have expert pension boards and capable staff who are incented to act in the best interests of fund participants and beneficiaries.

7.4 Should oversight of the PBGF continue to be assigned to Ontario's pension regulator or should it be moved to some other institution? What powers should the overseeing institution have to adjust premiums paid to and benefits paid from the plan?

If the PBGF is to remain in place, it should be managed by a team that has expertise similar to managing an insurance company.

7.5 What connection should any of the above changes have to rules governing the funding of pension plans?

The PBGF should not exist for reasons laid out in 7.1.

8.1 How should the PBA deal with plan mergers, splits and restructurings? How might such changes affect plan members? How might they affect plan funding?

PBA minimum standard rules should facilitate the ease in which plan mergers, splits and restructurings take place. If a successor employer is not prepared to continue the commitment of a defined benefit plan into the future, this should be enabled, as long as accrued entitlements are protected for the employee, excluding salary projections. In addition, there should be no requirement for the divesting organization to transfer surplus from their plan to the successor plan as surplus can be here one day and gone the next. It is only the liabilities that should transfer with assets to match those liabilities. This should be the minimum standard, but if an employer wants to do more than this they can at their discretion.

8.2 Should the same wind-up procedures apply to all kinds of pension plans, or do some require more intensive controls than others? Should wind-up procedures be simplified?

If partial wind-ups continue to be required, wind-up procedures should be simplified. Our view is that partial wind-ups are unnecessary and create unnecessary complications. Full wind-ups should have provision for distribution of surplus as set out in the plan. Wind-ups of defined contribution plans are significantly simpler than defined benefit and as such rules would be different for DC plans.

8.3 Should the pension regulator retain discretion within certain parameters to order a wind-up when the viability of the plan is at stake because of corporate restructuring or threatened insolvency?

Possibly, under very dire circumstances, but we are not sure what criteria the regulator would use to order a wind-up.

8.4 Should the PBA be amended to more specifically deal with pension plan mergers?

Yes. Minimum standards should be established. .

8.5 Should partial wind-ups in Ontario be eliminated entirely, as they have been in Quebec? If not, should Ontario adopt clearer or different rules concerning the distribution of plan surpluses and the preservation of "grow-in" rights in the event of partial wind-ups?

Yes, partial wind-ups should be eliminated in Ontario. If partial wind-ups are retained, clearer rules are required.

8.6 What would be the best approach to protecting the ongoing rights of plan members and pensioners, in the event of a material change in the identity, structure or financial circumstances of a sponsoring employer?

For changes in identity or structure, the employer and employees will jointly negotiate terms. If there is a change in financial circumstances, there could be an early warning system, like the CAMERA system by OSFI, to identify high risk pension funds. For these organizations, additional information requirements could be requested by the PBA to decide if a more intensive intervention is required.

9.1 Should Ontario be seeking to replace or reinforce existing interprovincial arrangements that give it responsibility for pension plans with members outside the province?

It is time to consider having a single pension law and single regulatory system for pensions in Canada. Interprovincial reciprocity arrangements are complex and not well understood. At a minimum, the checkerboard approach should not be adopted.

Instead, the rules where the plan is registered should apply to all pension provisions applicable the individual.

9.2 Should an effort be made to clarify and codify the law governing pension plan funding in Ontario? If so, should the PBA be amended to encompass matters now dealt with by the general law?

Yes, because the law is outdated. Subsequent legal decisions have not been incorporated which makes it more difficult for plan sponsors to apply the legislation.

9.3 Should an effort be made to ensure that pension plan sponsors and beneficiaries are better acquainted with their rights and obligations?

Yes. See response to 4.7.

9.4 Are the powers and staff resources of FSCO, the FST and the Superintendent of Financial Services adequate to perform the tasks presently assigned to them, and would the assignment of further responsibilities require additional powers and resources?

Some of our members have experienced delays in response time from FSCO staff, particularly on pension transfer transactions on divestitures, mergers and acquisitions. In some cases, asset transfer approvals have taken years, where members have terminated from the successor employer and even moved on to several subsequent employers and still do not know what happened to their pension monies. In addition, many of the interpretations of regulation are unclear and cause delays.

9.5 Should some of these tasks be reassigned to other bodies, such as the courts, or discontinued altogether?

As per our response to 9.1, we believe it is time for Canada to consider the need for one set of pension rules. Administrative complexity is one of the reasons plan sponsors are freezing/terminating DB plans.

9.6 What is an appropriate regulatory role for expert and professional bodies in the Ontario pension system?

Expert and professional bodies should have a means to be regularly consulted on legislative and regulatory change. This is key to adequate engagement and understanding of changes being contemplated and to influence the direction where appropriate.