



Report of the Ontario Expert Commission on Pensions: *A Fine Balance*

by **Clio Godkewitsch**

©2009 International Foundation of Employee Benefit Plans

On November 21, 2008, Commissioner Harry Arthurs met with key stakeholders to present the Report of the Ontario Expert Commission on Pensions, titled *A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules*. The report comes after a two-year examination of the pension regime in Ontario, including submissions from representatives of all pension stakeholders.

Ontario's Pension System

There are 1.76 million active and 850,000 to 950,000 retiree members of pension plans in Ontario that are regulated by the Financial Service Commission of Ontario (FSCO). In 2007, there were approximately 8,000 plans, one quarter of which were individual pension plans, almost half of which were defined contribution or hybrid plans, and 2,100 of which were defined benefit plans. However, about 80% of all pension plan members are members of a defined benefit plan.

The report shows that a declining percentage of workers—approximately 34.7% of the paid labour force in 2006—is covered by a pension plan. The report also states that pension plans are more frequent in the public sector, in large workplaces and in unionized workplaces.

About 80% of Ontario plan members are members of a defined benefit plan. About 55% of members are in a

single employer pension plan (SEPP) and 45% in a multi-employer pension plan (MEPP). Jointly sponsored pension plans (JSPPs), an important subgroup of both MEPPs and SEPPs, represent about 35% of all members in five public sector plans. In addition, the report points out that about 70% of members are in plans that have some element of member participation in governance, or voice through a collective bargaining agent.

Basic Principles

The report proposes a *fine balance*—a package of reforms that, together, are intended to enhance the viability of the system. The report considers the backlog of issues generated in each sector and proposes an array of recommendations to address them, all driven by several principles, which can be summarized as:

- **Security and Affordability.** The report recognizes that all pension arrangements contain an element of risk. Reducing risk entails costs, and the tension between benefit security and costs lies at the heart of many of the report's recommendations.
- **Degrees of Risk.** A significant principle underlying the report is that where employer and employee stakeholders cosponsor a pension plan, the plan should be entitled to assume more risk than a plan sponsored only by the employer.
- **Size and Sophistication.** While

the size of a pension plan does not necessarily determine its sophistication, large plans have the resources and the economies of scale to deliver high-quality administration and investment services. The report encourages consolidation and recommends that large plans be permitted to expand their memberships to take in additional members, and also that large plans be permitted to offer investment services to small plans.

New Funding Rules

The impact on funding is potentially significant for SEPPs. The report recommends retaining the current rules for funding on both a going concern and solvency basis, with some significant modifications. It recommends that actuarial reports for SEPPs permit a 95-105% "corridor" as a funding target. Plans greater than 95% funded should be permitted longer amortization periods (not specified), and plans under 95% funded must amortize deficiencies according to existing rules. In addition, the report recommends that if at any time a plan becomes less than 95% funded, contribution holidays cease (including periods in-between filings).

Another major recommendation is the elimination of excluded benefits from solvency funding, with the goal of increased transparency. This will im-

continued on next page

continued from previous page

pact plans with indexation or plant-closure benefits that now exclude those benefits for solvency valuation purposes.

However, the report recommends that solvency relief be extended to SEPPs if they elect to become *jointly governed pension plans* (JGPPs). This is a new category of pension plan not previously contemplated by the Ontario Pension Benefits Act (PBA). The report would require SEPPs to provide meaningful participation by employees and retirees in plan decision making by electing to become a JGPP. As a result, they will then become eligible for full solvency funding relief equivalent to the current specified Ontario multi-

continued from page 4

committee's costs payable out of the fund, or refusing to relieve the committee of the obligation to pay costs to the successful plan sponsor, was the fact that it was not clear that the committee's claims were brought on behalf of *all* plan members. Though the result in *Burke* is far preferable to the result in *Kerry* from a plan member's perspective, there is a certain degree of inconsistency in respect of the determination of whether or not the litigation was adversarial in these two decisions. In fact, it is arguable that the dicta respecting costs in *Kerry* has been varied; if *Kerry* stood for the proposition that costs cannot be ordered paid out of a pension fund where the plaintiff members' claims are adverse to other members' entitlements under a pension plan, *Burke* suggests that costs may be payable out of the fund where the claim has been brought on behalf of a large class, though not all, of the members of a plan.

(Reference: *Burke v. Hudson's Bay Company*, 2008 ONCA 690.)

employer pension plan (SOMEPP) rules. These rules permit the amortization of unfunded liabilities over 12 years and new benefits over eight years. They do not require funding on a solvency basis.

The report also recommends new rules on surplus. Subject to establishing legal entitlement in the plan documents or the consent of two-thirds of members, sponsors will be permitted withdrawal of surplus over 125% of liabilities in an ongoing plan. In addition, plan surplus will be distributed on wind-up according to the plan text or trust agreement, and if entitlement is not established by those documents, an arbitration process will be required to determine entitlement.

The report also recommends permitting the use of letters of credit subject to review and a further study of the feasibility of asset pledges. The report also recommends the elimination of quantitative investment rules and normalization of environmental, social and governance principles for those plans with the capacity to undertake active management of their investments.

The report recommends that plans address indexation, either by providing it or by containing a statement that it will not be provided, and communicating the effect of these provisions to members.

Another major recommendation of the report is retaining the temporary SOMEPP regulations and making them permanent, and extending them to jointly sponsored pension plans (JSPPs). Arthurs reasons that with member voice in governance, MEPPs and JSPPs are able to evaluate and agree to acceptable risks to members in the funding and governance of their plan. SOMEPP rules permit funding on a going concern basis only, and permit the amortization of unfunded liabilities over 12 years and new benefit liabilities over eight years.

On the other hand, the report is also cautious about going concern actuarial valuations and timing. It recommends that regulations require all promised benefits in going concern funding calculations, and increased overall trans-

parency in funding reports. Current rules technically permit the exclusion of certain benefits when calculating the value of liabilities. The report also recommends that asset values not be smoothed over several years, but be marked to market.

Other funding-related recommendations include:

- Permitting the use of letters of credit and a study of the possible use of asset pledges by sponsors
- The elimination of quantitative investment rules and normalization of socially responsible investing for plans with the capacity to undertake more active management of their funds
- Requiring plans to address indexation, even if that means creating a term of the plan and policy stating that there is no indexation
- Immediate vesting and phased retirement be implemented.

New Rules for Plan and Sponsor Transactions

The report recommends significant changes to the rules governing plan and sponsor transactions. It recommends higher thresholds for the superintendent to exercise discretion to order partial wind-ups and eliminates many of the consequences of a partial wind-up, including the distribution of surplus. Those plans that have early retirement benefits will be required to extend "grow-ins" to all terminated members of a plan.

The report also recommends significant changes to the use of surplus for the purpose of plan transactions. It recommends permitting the use of surplus in transactions, notwithstanding the presence of exclusive benefit language. In the case of plan conversions from defined benefit to defined contribution, surplus use would be permitted.

The report recommends that MEPPs and JSPPs be exempt from the effects of partial wind-ups. It recommends higher thresholds for the superintendent to exercise discretion to order partial wind-ups and eliminates many of the consequences of a partial wind-

up, including the distribution of surplus. The report specifically recommends that the grow-in rule not apply to MEPPs.

Governance

The report recommends that all jointly or member-governed plans develop enhanced governance policies to reduce conflicts, increase transparency and ensure representative decision making. These policies should permit trustees to be reasonably remunerated for their services, ensure the participation of active and retired members, improve disclosure to members, and prevent self-dealing or similar conflicts in investments. Many MEPPs in Ontario already promulgate similar policies.

However, the report is flexible in its implementation of these policies. It does not make specific recommendations about the content of each of these policies, leaving specific detail to each plan to determine in accordance with its own needs. For example, the report does not specify the number or percentage of trustees that represent retirees, or the process for determining how those trustees are to be appointed.

Ontario Pension Agency

Finally, with respect to plan transactions, the report recommends the creation of the Ontario Pension Agency, an agency to which members may have the option of transferring their benefits under a standard set of transfer rules. The purpose of this agency would be to permit members who move through more than one plan to have the option of consolidating their benefits in a single pension plan.

The Pension Benefit Guarantee Fund (PBGF)

The report recommends very significant improvements to PBGF. Most notably, it recommends increasing the benefits protected by PBGF to 100% of the consumer price index, or

about \$2,500, up from the \$1,000 limit currently in PBA.

In order to fund these protections, the report recommends the study and implementation of new risk-adjusted premiums for participating sponsors. Anticipating that this could incrementally increase the cost to plans, the report recommends transition measures for significant new changes. The report also increases exemptions from protected benefits to those made within the past five years prior to application.

The report also recommends a series of governance improvements to PBGF, separating it from FSCO and making it a standalone entity undertaking appropriate risk monitoring and evaluation of sponsors and plans. In this respect, the report recommends PBGF coordinate oversight with the new pension regulator.

A New Ontario Pension Regulator

The report recommends a very significant restructuring of the Ontario pension regulator. It recommends the establishment of a standalone pension regulator focused exclusively on pension regulation. The new regulator will have a clearer mandate and defined role than FSCO or the prior Pension Commission of Ontario, and significant new staff and capacity. The powers of the superintendent are expanded and will include rule making (with notice and comment) as well as power to issue advanced rulings, intervene more frequently in at-risk plans and engage more frequently with stakeholders. The notice of proposal system will be streamlined, and a series of new regulatory initiatives are proposed.

Part of the new regulatory model is the establishment of a new administrative tribunal mandated to hear appeals from the superintendent and pension-related disputes. The report recommends this tribunal be staffed by full-time experts and have exclusive jurisdiction over pension disputes.

Policy and Innovation

Two chapters of the report deal with new ways to encourage engagement with stakeholders and drive innovation in pension policy. The report recommends the creation of a new agency, the Pension Champion, mandated to engage with stakeholders and bring forward new ideas and policy proposals to the government, regulator and stakeholders. The Pension Champion is to be supported by a consultative body, the Pension Community Advisory Committee, in which stakeholders participate.

The mandate of the Pension Champion appears to include:

- Encouraging the creation of larger plans to take advantage of opportunities that come with scale
- Expanding data collection and analysis by working with the regulator and others
- Studying new plan designs and recommending legislative and policy proposals
- Seeking harmonization across Canada where possible.

The report also states in several places that the Ontario government should approach the federal government to discuss other possibilities for expanding pension coverage, including the expansion or modification of the Canada Pension Plan, and to urge reforms to the Income Tax Act (Canada).

Next Steps

Ontario Minister of Finance, Dwight Duncan has invited stakeholders to make submissions in response to the report by February 27, 2009. He has also committed to passing legislation in response to the report, though it is unknown what recommendations he will take steps to implement. The report states in several places that it is a measured policy response to conditions in the pension industry and stakeholder concerns. It proposes a fine balance as a package of reforms that, together, purport to enhance the viability of the system.

(Reference: The Ontario Expert Commission on Pensions, *A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules.*) •