Report of the Expert Commission on Pensions

A Fine Balance

Safe Pensions
Affordable Plans
Fair Rules

Ontario

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EXPERT COMMISSION ON PENSIONS

COMMISSION D'EXPERTS EN REGIMES DE RETRAITE

October 31, 2008

Hon. Dwight Duncan
Minister of Finance for Ontario

Dear Minister Duncan,

I have the honour to present to you *A Fine Balance*, the report of the Ontario Expert Commission on Pensions.

While as Commissioner I remain solely responsible for the text of the report and its recommendations, these are the work of many hands — those of my public-spirited as well as expert Advisors, of my hard-working and capable staff and, not least, of the many Ontarians who communicated their hopes and concerns, and contributed their knowledge and views, to the Commission over the past two years. In addition, the Commission's work was greatly assisted by research studies undertaken for it by Canadian and international pension experts, by the information provided by the Financial Services Commission of Ontario and by the logistical support provided by the Ministry of Finance.

I thank the many individuals, organizations and agencies referred to above for their willingness to address frankly, intelligently and constructively the difficult issues of pension policy, law and administration that fell within my mandate. And I thank you, Mr. Minister — and your predecessor, the Hon. Greg Sorbara — for the opportunity to serve as Commissioner.

The aspiration to strike the right balance — a fine balance — among safe pensions, affordable plans and fair rules is widely shared across the pension community and beyond. I wish you and your officials every success in working with all interested parties to find such a balance and to translate it into a new pension regime for Ontario.

Sincerely,

H.W. Arthurs
Commissioner

TABLE OF CONTENTS

Published Separately by the Ontario Expert Commission on Pensions

The following documents are available on the website www.ontario.ca/pensions. The website also provides access to all briefs and submissions received by the Commission. All research studies undertaken for the Commission are available on request from Publications Ontario.

Discussion Paper

Interim Report

Summary of the Commission's final report, *A Fine Balance*

Technical Annex: Sources referred to in the final report and brief summaries of research studies undertaken for the Commission

Expert Advisors' Consensus Recommendations on Technical and Operational Issues

CHAPTER ONE – INTRODUCTION

1.1 The Commission and Its Work

1.1.1 The establishment and membership of the Commission

The Ontario Expert Commission on Pensions was established in November 2006 by the Hon. Greg Sorbara, then Minister of Finance, to "examine the legislation that governs the funding of defined benefit plans in Ontario, the rules relating to pension deficits and surpluses, and other issues relating to the security, viability and sustainability of the pension system in Ontario." In October 2007, Mr. Sorbara was succeeded by the Hon. Dwight Duncan, whose interest in and support for the Commission's work is much appreciated.

The Commission's mandate and guiding principles, the factors it was directed to consider, and the specific issues it was invited to address are all found in its terms of reference, reproduced in Appendix One.

As sole Commissioner, I accept full responsibility for the preparation of this report and for the form and substance of its recommendations. However, I am eager to acknowledge the great assistance and wise counsel provided by my four distinguished expert and representative advisors: Bob Baldwin, Kathryn Bush, Murray Gold and Ian Markham. Their insights — shaped by their different disciplinary backgrounds and roles in the pension community — were instructive, influential and indeed, indispensable to the work of the Commission. Their résumés are found in Appendix Two. As well, the Commission's small but dedicated and capable staff cheerfully bore the main burdens of the Commission's work, providing me with research, analysis and guidance — and occasionally sceptical questions — at each stage of the undertaking. Their names and backgrounds are also recorded in Appendix Two. Finally, the Ministry of Finance and the Financial Services Commission of Ontario (FSCO) provided the Commission, respectively, with logistical support and with access to information required by the Commission.

1.1.2 The Commission's work process: public consultation, engagement with the stakeholders and research

The work of the Commission began with the preparation of a discussion paper that was issued in February 2007. This paper translated the terms of reference into a series of propositions and questions designed to launch a conversation about pension policy, which all Ontarians — stakeholders, experts and interested citizens — were invited to join. That conversation continued throughout 11 days of public hearings in October–November 2007 in five Ontario cities at which 74 organizations and individuals presented formal briefs. A further 53 individuals or groups made submissions, either informally to Commission staff at the hearings, electronically or by letter. All of the briefs and submissions were informed by the presenters' experience with the pension system; many involved extensive research and proposed imaginative solutions; and none failed to contribute to the Commission's overall understanding of the issues it was mandated to consider. A list of all briefs and submissions is found in Appendix Three.

In addition, as Commissioner, I provided informal briefings to an array of key actors in the pension system: unions; retirees' and seniors' organizations; representatives of different types of pension plans; organizations of small, medium and large employers in the public and private sectors; service providers; professionals; regulators; and policy makers. The participating organizations are identified in Appendix Three.

These briefings, which occurred both prior and subsequent to the public hearings, were designed to ensure that the Commission was addressing issues of concern to the full array of stakeholders; that the stakeholders were in turn aware of the Commission's *modus operandi* and its general approach to the substantive issues; and that so far as possible, the Commission's report and recommendations would be, and would be seen by stakeholders to be, informed, balanced and practical.

While the stakeholders' views were often partisan and strongly held, virtually all of them voiced support for the efforts of the Commission and offered cooperation in the search for outcomes that would be beneficial and acceptable not only to themselves but also to all interested parties. Indeed, in several cases, stakeholders contributed directly to the Commission's work. Morneau Sobeco, a consulting firm, generously shared with the Commission its concordance of Canadian pension legislation. The Pension and Benefits Section of the Ontario Bar Association, whose members represent both employers and unions, supplemented this concordance and produced as well a brief containing many technical suggestions designed to facilitate the administration of pension plans. FSCO kindly convened a forum on funding issues, involving its own representative advisory committees. And four actuarial firms — Hewitt Associates, Mercer, Morneau Sobeco and Towers Perrin — undertook *pro bono* to model various proposals contained in submissions to the Commission; the last firm must be singled out for particular recognition given the immense time commitment its staff made to the project. Two individual actuaries, Shiraz Bharmal and Brian FitzGerald, also devoted time *pro bono* in support of the Commission's research. These gestures of goodwill from members of the pension community not only facilitated the work of the Commission in practical ways, but they also reinforced its conviction that the stakeholders are indeed anxious to cooperate in building a better pension system for Ontario.

Finally, the Commission made every effort to ensure that its work would be informed by high-quality research, and that the insights derived from that research would be as free from partisanship as possible. After consulting some 60 experts in the field at three meetings in February, March and April, 2007, it devised a research program comprising 17 studies by independent experts from across Canada and in several other countries. The studies were designed to be objective, to bring the Commission and the pension community up-to-date on relevant developments, and to be user-friendly, in the sense that they would be easily accessible not only to the Commission but also to other readers. They were, in fact, almost all delivered in timely fashion and in accordance with these criteria. Executive summaries of the commissioned research studies are posted on the Commission's website (www.ontario.ca/pensions) and the full text of each study is available upon request. A list of those attending the expert consultations and of those who undertook studies can be found in Appendix Four.

The Commission's report has therefore not only been informed, but also definitively shaped by the careful research, shared experiences and expert advocacy of scores of stakeholder representatives, pension professionals, academics, consultants and administrators; by the expertise of the Commission's advisors, staff and researchers; and by the views of ordinary Ontarians who provided formal briefs, participated in the consultations and public hearings, or simply told us of their experiences and concerns. As well, the report reflects suggestions made by the many stakeholders who worked with the Commission to ensure that it offers a balanced response to the many complex issues confronting Ontario's pension system.

1.2 Ontario's Occupational Pension System in Historical and Constitutional Perspective

Ontario workers have been receiving "occupational" pensions, provided by their employers, since the middle of the 19th century. Reports and studies on the pension system can be traced almost to its inception, but at least as far back as 1889. A central theme of these studies, of pension policy debates throughout the 20th century and of current discourse has been the issue of whether pensions should be provided directly by the state; by employers under a legal obligation to provide them; or by employers acting either "voluntarily" out of charity to faithful, long-serving employees, to aid the recruitment and retention of workers, or to satisfy the collective bargaining demands of their unionized employees. At stake, of course, were — and still are — issues such as whether pensions should be available to everyone, how the pension system should be financed, and by what means and to what extent it should be regulated.

By the mid-20th century, occupational pensions were becoming more common in large unionized workplaces, especially in the public sector, and were increasingly available in large, non-unionized enterprises. Nonetheless, the controversy over who should provide pensions continued. In this province, it reached a crucial stage in 1960 when the Conservative government of the day appointed the Ontario Committee on Portable Pensions. The Committee's reports in 1961 and 1962 made clear its conviction that no system, short of a universal, contributory system, would achieve desired levels of coverage or solve the problem of pension portability. However, instead of a state-administered scheme, the Committee proposed that all employers with 15 or more employees be required to provide pension coverage to their employees, funded by contributions from both parties. To facilitate the operation of this scheme, it proposed the enactment of a *Pension Benefits Act*, and the establishment of two bodies. The first, the Pension Commission of Ontario (PCO), was to exercise regulatory oversight of the pension system. The second, the Central Pension Agency, was to be a federally chartered privately funded corporation, with a mandate to provide administrative and investment services in support of employer-sponsored plans and to facilitate pension portability.

The Committee's recommendations were accepted and the legislation it proposed was enacted in 1963. But before the *Pension Benefits Act* could be implemented, the introduction in 1965 of the compulsory, contributory and universal Canada Pension Plan (CPP) radically altered the policy landscape. While CPP pensions were relatively modest (as were other age-related social supports), from this point forward it was generally assumed that, for better or worse, "voluntary" occupational pensions would continue to exist alongside the CPP rather than be replaced by it. Consequently, Ontario's pension system came not to be a "system" at all, but rather a number of independent plans sponsored by individual employers or groups of employers, governed by these sponsors either alone or in collaboration with workers and their representatives, and sometimes funded by member as well as sponsor contributions.

Naturally enough, pressures arose to regulate those plans with a view to ensuring that they delivered the promised pensions. New regulatory measures were enacted to strengthen the financial integrity of the various independent plans. The PCO, established in 1963, was originally given a broad mandate to "promote the establishment, extension and improvement of pension plans throughout Ontario," and later acquired some policy-making capacity and extensive regulatory powers commensurate with its mandate.

However, it soon became clear that not all problems relating to occupational pension schemes had been laid to rest by the enactment of the 1963 Ontario statute or the advent of the CPP in 1965. On the contrary; in 1977 the Commission on the Status of Pensions in Ontario (the Haley Commission) was appointed to address, among other things, the very concerns identified by the 1960 committee — coverage and portability. The Haley Commission ultimately endorsed the analysis of the earlier committee and recommended that Ontario adopt a universal, compulsory and contributory pension scheme — but its recommendations were not accepted.

On the other hand, during the 1980s more pragmatic legislative initiatives were undertaken to protect the interests of active and retired members under occupational pension plans. These included the introduction of "grow-in" rights for employees nearing the age when they would be eligible for early retirement arrangements, the establishment of the Pension Benefits Guarantee Fund, which would provide beneficiaries with partial compensation in the event of plan failure, and expanded powers for the pension regulator. A revised *Pension Benefits Act* consolidated these changes in 1987, the last occasion on which the legislation was comprehensively reviewed and amended.

During the mid-1980s, attention shifted from regulatory issues to the effects on pensions of significant and sustained inflation. Based on a number of commissioned studies, the Friedland Task Force, in its 1988 report, recommended partial indexation of pensions. Its recommendations were incorporated in legislation in 1990 that, however, has neither been proclaimed in force nor accompanied by implementing regulations.

In addition to concerns about inflation and indexation, controversies concerning funding began to dominate the policy agenda in the 1980s, and continue to do so to the present day. Sponsors and active and retired plan members have asserted conflicting claims to ownership or control of surplus funds; debated the propriety of contribution holidays; and expressed widely differing views on how rapidly, by what means and to what extent funding deficits ought to be made good. Some of these controversies were resolved by ad hoc amendments, consolidated into the *Pension Benefits Act, 1987* and regulations, whose overall effect was to make funding rules and reporting requirements more stringent. Additional funding controversies were provoked by the restructuring of Ontario's public and private sectors during the 1990s, which triggered mergers and acquisitions, full and partial plan wind-ups, asset transfers, insolvencies and near-insolvencies, and the often involuntary relocation of active members from one plan to another, or from a job with pension coverage to one without. Finally, turbulence in financial markets, especially in the years following 2000, has raised many difficult questions concerning the funding status of plans and the adequacy of regulatory oversight and intervention.

These controversies have had to be addressed within a legal–regulatory framework that itself was experiencing rapid change.

In 1998, the PCO was replaced by FSCO, which (unlike its predecessor) regulates not only pension plans but also credit unions; cooperatives; and insurance, loan and mortgage companies. The result, some contend, is that pension law, policy and adjudication now reside within a regime whose primary focus is the regulation of financial markets. At the same time, the PCO's adjudicative functions were transferred to a quasi-independent body, the Financial Services Tribunal (FST), whose mandate tracks that of FSCO. The result, many in the pension community believe, has been a loss of expertise in and focus on specialized pension problems.

To some extent, however, the PCO's dominant role in the elaboration of pension law and the interpretation of pension legislation had come to be shared with the courts. This occurred both in the context of judicial review proceedings brought against FSCO and the FST and — following the *Dominion Stores* case (1986) — in the context of civil proceedings based primarily on the general law of trusts. Furthermore, over the past two decades, insolvency litigation has acquired increasing significance for pension plans, as many Ontario companies with plans have found themselves in difficulty in the new global economy.

Judicial rulings have been seen by some as conferring new rights on plan members and imposing new obligations on sponsors, and by others as clarifying rights and enforcing obligations that had existed all along.

However, quite apart from their substantive merits and precedential effects, some observers fear that increased recourse to the courts to determine pension rights has introduced new litigation-related costs and uncertainties into pension plan administration and regulation.

The recent development of pension policy is further complicated by its intertwining — beginning early in the 20th century — with income tax policy and administration. On the one hand, the federal *Income Tax Act* (ITA), by treating contributions as a deductible business expense, provided incentives to employers to establish and maintain occupational pension plans. On the other, by sheltering their deferred income from taxation until they retired, it provided incentives for workers to participate in such plans. Indeed, for some years, until 1991 when it "levelled the playing field," the ITA provided more favourable treatment to retirement savings based on defined benefit (DB) plans than to other savings vehicles such as individual retirement savings plans.

However, pension policy has paid a price for its dependence on tax incentives. Over time, provisions of the ITA became a major determinant of pension fund design and of contribution and benefit levels. But despite the fact that provisions of the ITA sometimes require sponsor action that might be deemed contrary to good pension policy, Ontario — for constitutional reasons explored below — lacks the power to alter or neutralize those provisions. This has resulted in something of a policy impasse. A similar impasse exists with respect to the effects of federal bankruptcy and insolvency law on provincial pension policy.

Finally, the development of pension policy has been affected by norms, which emanate neither from legislatures nor courts, but from professional bodies. To cite two prominent examples, actuarial standards establish how pension fund valuations are conducted and how the results are viewed for regulatory purposes, and accounting standards determine how the assets and liabilities of pension plans will appear on the books of the sponsoring employer.

This brief history of pensions and pension regulation in Ontario reminds us that, while the system we know has some continuities with the past, a good deal has changed. For one example, occupational pensions have come to be seen less as largesse conferred by employers and more as entitlements earned by workers as part of the total compensation promised them in the wage bargain. This altered perspective has led to pension plans achieving the status of virtual financial subsidiaries of the sponsoring firm, whose financial well-being may be intimately intertwined with that of the plan. And of course, in unionized workplaces, it has led to pensions becoming the focus of intense negotiation and, occasionally, conflict. Another example: pensions are increasingly perceived not just as a series of bargains struck in individual workplaces, but as a quasi-system whose fate has significant implications for the province's social policy and economic well-being. And one more: the role of law and legal–regulatory institutions has become much more prominent. In 1961, the Ontario Committee on Portable Pensions could dismiss the issue in a few lines, saying that while lawsuits arising out of pension trusts had occurred in the United States, it was "not aware of similar litigation in Canada." I could hardly say the same today.

On the other hand, some things seem never to change. Two important examples make the point. First, debate continues on the fundamental issue of whether income security in retirement is a matter of personal responsibility to be addressed (if at all) by some combination of voluntary, employer-provided pension plans and/or personal savings by workers, or by contrast, a matter of social justice to be resolved through some combination of state pensions, pensions provided by employers under requirement of law, and mandatory or incentivized savings by workers. Issues such as the extent of pension coverage and pension portability are closely related to this critical point of contention, and are dealt with later in this report on the assumption that Ontario will continue to have a voluntary pension system. However, I must note that this assumption was seriously challenged by many briefs to the Commission, from a variety of stakeholders, with a variety of concerns and of proposals for new policies. While, given my mandate, I am unable to contribute much to this debate, I do return to it later in this report.

Second, debate also continues over how to deal with the constitutional division of powers, which prevents the creation of a unified body of national pension law coextensive with the boundaries of Canadian corporate structures, labour markets and pension plans. From their inception, occupational pensions — like most employment-related concerns — were characterized for constitutional purposes as matters involving "property and civil rights" and as matters of a "local and private nature" — both heads of provincial legislative authority. However, the Constitution was amended in 1951 to permit the federal government to legislate "in relation to old age pensions and supplementary benefits." This is the constitutional foundation of today's public pension systems — notably the Canada/Quebec Pension Plan (C/QPP) and the Old Age Security (OAS) program. But the older view was only modified, not erased. The 1951 amendment contained a specific proviso to ensure that federal pension legislation would not "affect the operation of any law present or future of a provincial legislature in relation to any such matter."

Thus, despite the existence of the CPP, each province retains jurisdiction to regulate occupational pensions and almost all have now done so. But that does not dispose of constitutional controversies. The federal government also has paramount power to legislate in regard to "any mode or system of taxation" as well as "bankruptcy and insolvency," even when the effect of doing so may be to interfere with or supersede provincial pension laws. As will be seen, many significant proposals for reform of Ontario's pension system therefore depend on the changes being made to the *Income Tax Act*, the *Bankruptcy and Insolvency Act*, or the *Companies' Creditors Arrangement Act* — all federal statutes.

Further constitutional complications arise from the fact that the provinces and the federal government may each legislate with regard to the pension rights and obligations of employers and employees who fall within their respective jurisdictions. About 10% of the Canadian workforce — those in the federal civil service; the armed forces; and federally regulated industries such as transportation, banking, broadcasting and telecommunications — falls under federal pension legislation of some sort. The remaining 90% is, in principle, governed by the pension law of the province in which the worker resides or works. However, not only do workers move from one jurisdiction to another, but pension plans also often cover workers in several jurisdictions. Because the federal government, the provinces and the territories have somewhat different laws — sometimes for no discernible reason — this constitutional division of regulatory authority can cause considerable administrative difficulties for mobile workers, nation-wide plan sponsors, and service providers and pension regulators.

These difficulties might be alleviated in several ways. The first is for the various governments to agree to establish a single national pension regulator. This seems unlikely to occur any time soon. The second is for each government to agree to harmonize its pension legislation with that of the other jurisdictions so that compliance with one statute would, in effect, ensure compliance with all. This project has been pursued sporadically over the years, but it too seems a distant prospect.

A third, more pragmatic, approach is the one that has in fact been pursued. The provinces, in 1968, agreed among themselves that whichever province is the place of work of a plurality of active plan members has jurisdiction to regulate the plan for all of those members and for almost all purposes. This solution at least localizes regulatory responsibilities and, as a by-product, avoids the risk of serious regulatory competition among the provinces. However, it is by no means perfect. Provincial common, civil and statute law continues to apply in litigation over pension rights and, as noted, federal legislation applies to workers in federally regulated enterprises and federal public employment. Plan documents must therefore take account of local legal and regulatory requirements — sometimes in a dozen jurisdictions. Moreover, if the balance of the plan population shifts from one province to another, perhaps as a result of corporate merger or divestment, regulatory authority shifts, too, and the plan must reconfigure itself to meet the requirements of its new "home." And finally, the absence of uniform legislation creates difficulties for workers who want to carry their pension to a new job in another jurisdiction.

Frustration with these constitutional and jurisdictional difficulties was frequently and justifiably expressed during the Commission's hearings. However, I obviously have no authority to make recommendations to the persons or bodies who would have to cooperate to resolve these difficulties: the federal Ministers responsible for taxation and for bankruptcy and insolvency legislation; the federal and provincial Ministers responsible for pensions (who have not met together for many years, perhaps because responsibility for pension policy resides with different ministries or agencies in various Canadian jurisdictions); and the Canadian Association of Pension Supervisory Authorities (CAPSA). I will not be the first person to call on Ontario's Minister of Finance to use all available means to bring these jurisdictional issues to the attention of his federal and provincial counterparts with a view to solving the common problems of Canada's pension systems — but I would be happy to be the last.

1.3 What Are Occupational Pensions For?

As noted earlier, this report concerns occupational pensions provided by employers to their workers, and not pensions provided to everyone by the state. The obvious purpose of all such pensions is to ensure that workers have greater means to support themselves after they leave the workforce than are provided by the C/QPP and OAS. However, not only do different types of occupational pensions provide such support in different ways and to different degrees, but they also fulfil a number of other important social and economic functions. What follows is a brief review of these pension types and of the functions they fulfil, both of which are dealt with in greater detail in succeeding chapters.

1.3.1 Types of occupational pension plans

Not all occupational pension plans are calculated, funded, paid out and regulated in the same way. They come in two basic models: *defined benefit* plans and *defined contribution* (DC) plans. At present, perhaps 90% of Ontario retirees and 80% of active plan members receive or expect to receive pensions classified for regulatory purposes as DB pensions; the rest receive or expect to receive pensions classified as DC pensions. However, "pure" DB and "pure" DC plans are constantly mutating into variant forms, many of which combine elements of both. Indeed, variants — notably multi-employer pension plans (MEPPs) — now enrol in the aggregate more members than either "pure" model.

The *Pension Benefits Act* treats DB plans as paradigmatic; the mandate of this Commission mentions them specifically; and many of the regulatory and funding problems I was asked to resolve are unique to DB plans. A brief description of these plans, and of the DC alternative to them, is therefore necessary.

Under DC plans, employers ("sponsors") agree to contribute a fixed percentage of salary or dollar sum per week or month toward an employee's pension; hence, "defined *contribution.*" The accumulated contributions are invested on behalf of that employee; the total proceeds — contributions and investment earnings — are then used to provide the employee with a pension on retirement. Some DC plans require or permit contributions from the employee as well.

By contrast, "true" DB plans commit the sponsor to provide retirees with pensions of a fixed or ascertainable amount; hence, "defined *benefit.*" The level of the pension benefit is calculated by reference to a specified benchmark — most commonly some combination of the level of the employee's earnings and his or her length of service. In some cases, DB pensions are calculated as a proportion of the wages the employee earned during the final or best-paid years of their employment; in others, as a percentage of average earnings across their whole career; and in still others, as a "flat" or fixed sum payable on retirement in respect of each month of employment.

Unlike DC plans, DB plans do not earmark specific accounts for the support of individual retirees. Rather, the plan's entire assets are available to meet all of its obligations. If funds are inadequate at any point to meet those obligations, the sponsor must contribute additional funds to make good the deficiency. As a result, the risks that retirees will live longer than anticipated, or that the plan's investments will perform below expectations, are largely assumed by the sponsor, not by the plan members.

However, in contributory plans where the employees themselves are joint "sponsors," they ultimately bear some part of those risks as well. Indeed, it is sometimes claimed that, in effect, they do so in all DB plans, contributory or not. This controversial claim is investigated in subsequent chapters.

It is widely believed that DB plans produce better financial outcomes for retirees than DC plans, though they are likely to cost sponsors more. Moreover, because workers can predict what a DB pension will yield with relative accuracy, they can plan for their own retirement with greater certainty that they will not experience a dramatic decline in their living standards. And because these pensions are sometimes (not always) linked with other features (more aggressive investment strategies; partial or *ad hoc* indexing to mitigate the effects of inflation; additional non-pension benefits, such as extended health care coverage), DB plans have tended to be especially popular with workers. Finally, several types of DB plans, such as multi-employer plans and jointly sponsored plans, offer members and their union or other association a role in plan governance.

DB and DC plans, and all their many variants, have a significant impact on Ontario's social policy and economy. An extended account of this impact is found in Chapters Two and Three; what follows is a brief summary of the findings in those chapters, which will help to explain the nature and importance of the issues confided to the Commission.

1.3.2 Income security for older Ontarians

Occupational pensions represent an important source of income support for retired Ontarians. Other sources include publicly funded programs such as the C/QPP, OAS, Guaranteed Income Supplement (GIS) and other social welfare programs; special programs for seniors such as assisted housing or subsidized prescription drugs; individual registered retirement savings plans and other private investments; and post-retirement full- or part-time work.

At a rough estimate, more than one in four Ontarians (3.0 to 3.5 million out of a total population of 12.0 million) is directly involved with the occupational pension system as a plan member — a proportion that rises if we include their dependants and domestic partners. Occupational pensions account for, on average, 20% of the total income received by retirees, although the percentage varies greatly depending on the individual's work history and overall economic situation.

Consequently, significant changes in the coverage and quantum of occupational pensions will almost certainly significantly affect the overall system of financial security for older Ontarians.

1.3.3 Labour markets

Pensions were once regarded as a form of gratuity used to reward "good and faithful servants" at the end of their useful working life. However, they soon became a device employers could use to attract and retain the skilled and semi-skilled workers they needed. These "golden handcuffs" bound workers to the employer who originally invested in recruiting and training them and who wanted to amortize that investment over the full duration of their working lives, or to ease transition to early retirement when their services were no longer required. Finally, the success of unions in securing pensions for their members to insulate them from poverty in their old age is rightly regarded as one of their most significant achievements. In addition, unions have learned to use pensions to mediate the competing preferences of their younger and older members and, sometimes, to influence business decisions — not just by the sponsor–employer but by other corporations in which their pension funds are invested.

That said, economists have observed that pensions — especially DB pensions that are not easily portable from one job to another — may inhibit the mobility of workers and create inefficiencies in the labour market. They also note that the increasing cost of pensions represents additional labour costs, which many sponsor firms can ill afford in an era of intense global competition.

Labour markets are undoubtedly changing, in ways that are examined in greater detail in Chapter Three. Some of these changes may put pressure on employers to reinvigorate the pension system; others may have the opposite effect.

1.3.4 Capital markets

Pension plans, after the chartered banks, have become the largest single source of investment capital in Canada and, almost certainly, in Ontario. Moreover, while the evidence is somewhat unclear, pension plans seem to be particularly important suppliers of capital for infrastructure and similar long-term projects. If active and solvent occupational pension plans were not available to invest in infrastructure, or to make the other kinds of strategic investments increasingly made by pension plans today, it would be necessary to find an equally attractive alternative source of capital. This would not be easy and the results could be harmful to Ontario's economy.

1.3.5 General economic effects

Ontario's economy generally benefits from a healthy occupational pension system. The ability of retirees with reasonable incomes to pay for goods and services, for example, generates jobs for those who supply them. The fact that retirees can pay for these goods and services from their own resources rather than from government-provided pensions helps to reduce the need for higher taxes, which in turn contributes to a more positive environment for business investment. The province's ability to hold the line on taxes and to maintain the spending power of seniors will be increasingly crucial to the future health of its economy, as a higher and higher proportion of its adult population retires from the workforce and retirees spend longer and more active lives in retirement.

1.3.6 Conclusions and implications

For all of these reasons, it is important that Ontario should have a healthy occupational pension system. Unfortunately, that system — especially its dominant sector, DB plans — has been in gradual decline for at least 30 years. For all of the reasons that the growth of occupational pensions is widely regarded as positive, their decline must be regarded as potentially negative for Ontario, its workers and employers, its seniors, and the communities and markets they inhabit. That, no doubt, is why the Commission's mandate is driven by concerns relating to "the security, viability and sustainability of the pension system in Ontario."

1.4 The Challenges Confronting the Commission

The first challenge confronting this Commission is to better understand the causes of the decline in Ontario's pension system; the second is to propose strategies by which to arrest and, if possible, reverse it; and the third is to identify for future consideration alternative approaches that might fill the gap — if indeed, the occupational pension system as we know it cannot be fixed or cannot provide all of the social and economic benefits of a more comprehensive pension system.

1.4.1 Understanding why the pension system is in decline

As explained in Chapter Three, I have encountered no shortage of explanations for the decline of Ontario's pension system. Some hold that the DB system was fatally flawed from its inception during the post-war period when, like many social experiments, it was built upon assumptions concerning endless economic growth. The falsity of these assumptions (they argue) becomes evident in times of financial or political crisis. Others hold that labour market developments — declining union density, disemployment in economic sectors where pension enrolment has historically been concentrated, and changing workforce demographics — are to blame. Still others hold that the system suffers from self-inflicted wounds: an excess of expectations, regulation, litigation, rigidity and cost; an insufficiency of fairness, oversight, asset security and benefits; and an inability to accommodate pension plans within the changing discourse of the legal, economic, accounting and actuarial professions.

1.4.2 Legal and regulatory reform as a strategy to arrest or reverse the decline of occupational pensions

The Commission's terms of reference include explicitly or by implication almost all of these explanations in their articulation of "guiding principles" and "factors to consider." However, the terms of reference give special prominence to a number of specific legal and regulatory concerns as "issues to be addressed in the report." Those issues, and others closely linked to them, are carefully addressed in chapters of the report that focus on the rules governing plan funding, the consequences for plans of the restructuring of the sponsoring organization in our changing economy, problems arising out of plan failure, the effectiveness of the existing regulatory framework, and the need for attention to innovation in plan governance and design. These are extremely important issues, and if they are not resolved appropriately, the future of the occupational pension system will clearly not be — in the words of my mandate — "secure," "viable" or "sustainable."

1.4.3 Alternative strategies

However, the converse is not true: if appropriate legal and regulatory rules, institutions and processes are put in place, it does not necessarily follow that the pension system will be stabilized or reinvigorated. This possible disjuncture between underlying concerns about the system, and the specific issues identified for my analysis and recommendations, was a recurring theme of briefs and research studies received by the Commission, as well as of many conversations with stakeholders. The gist of these briefs, studies and conversations is that the Commission ought to investigate and recommend transformative developments in pension design, funding, regulation and policy that would amount to a virtual reinvention of the occupational pension system, or even its replacement.

Clearly, I had no mandate, nor did the Commission have the time or resources, to investigate the most ambitious of these alternative strategies, and it did not do so. However, in deference to the force of the imaginative proposals presented, and to the good will and creativity of those who presented them, I am anxious that they should not simply disappear from view. Accordingly, they are recapitulated in Chapters Nine and Ten so that they can be considered within the context of a larger, longer-term discussion about how to ensure that Ontarians have the kind of income security in retirement that they need and want.

1.4.4 Technical and operational issues

The Commission also learned of a number of technical and operational difficulties arising within the pension system or closely related to it. These difficulties have sometimes adversely affected the interests of individual plan members, sometimes created problems for sponsors, and sometimes unnecessarily complicated or constrained the work of the pension regulator. However, most do not raise fundamental issues of policy, and most are capable of being resolved by relatively straightforward, or at least non-controversial, changes in the law or in regulatory practices.

Commission staff have compiled a list of these matters, with contributions from members of the pension community and from FSCO. My Expert Advisors, using this list, have prepared a Memorandum for the Ministry of Finance (supplementary to this report) suggesting how these difficulties might be resolved in ways that are likely to be acceptable to most members of the pension community. I believe that these technical and operational issues can and should be dealt with promptly, both on their individual merits and to ensure that they do not cumulatively detract from the smooth running of the pension system.

1.5 Assumptions and Principles Underlying This Report

While occupational pensions in Ontario have been the subject of several previous comprehensive reviews, most efforts at reform over the past 20 years could fairly be described as *ad hoc* rather than principled, and issue-specific rather than systemic. There are good reasons for this, the most important being that pension reform is both technically complicated and politically controversial. However, the result is that an important domain of public policy has not been subject to thorough review for over two decades. Much has changed during that time, within both the pension community and the broader society and economy. Much more is apt to change in the years ahead, since pension policy is likely to become even more important as the province engages with the problems associated with an aging population. A broad and informed review of Ontario's occupational pension system, and of the legal regimes by which it is regulated, is therefore very much in order. The fact that so many other jurisdictions in Canada and elsewhere have been re-examining, and sometimes re-designing, their pension systems reinforces this conclusion.

Fortunately, my mandate contemplates such a review. It articulates a number of "guiding principles" and "factors to consider," enumerates a number of specific "issues to be addressed," and concludes with a "general" instruction to consider "pensions as an important policy instrument that support workforce attachment and foster an entrepreneurial economy" — as well as "any other matters relevant to enhancing the viability of DB pension plans in Ontario." But the mandate is not infinitely broad: I am specifically enjoined to produce recommendations that are "practical, affordable and implementable."

However, these various components of my mandate — guiding principles, factors to consider, issues to be addressed and the need for practical recommendations — are not always easy to reconcile. Practicality may be at odds with principles, and principles may exist in tension with each other. Giving undue weight to some of the factors and issues — essentially, current controversies within the present system — may foreclose approaches that have not yet been tried. And finally, proposals for sound, principle-driven reforms that might "enhance the viability" of the defined benefit system risk being characterized as politically "unimplementable" if they challenge the conventional wisdom or existing alignments of interest.

For all of these reasons, I have tried to ensure that while my recommendations are sensitive to the positions expressed in briefs and stakeholder discussions, they are ultimately based on sound evidence and analysis and, especially, grounded in principle. This approach has left me with ample room to recommend from among a range of acceptable solutions those that seem the most practical, affordable and implementable. My emphasis on evidence, analysis and principle has several positive features: it imposes structure and discipline on my analysis; it forces me to acknowledge the existence of contradictions within pension policy and of conflicts among stakeholders; and it reminds stakeholders of the need for sensible compromises. It also provides those stakeholders, as well as general readers, with benchmarks against which to evaluate this report.

In the discussion that follows, I review the assumptions — the "factors to be considered" — and flesh out the "guiding principles" that inform the report. In subsequent chapters, I draw on these same assumptions and principles to analyse specific issues and make the case for specific recommendations.

Principle: Maintain and encourage defined benefit pension plans

The Commission's mandate rests on several implicit and explicit assumptions: that DB pensions provide workers with an important form of income security upon retirement; that they thereby relieve pressure on the publicly funded social safety net; that they are useful to employers; that they represent significant aggregations of investment capital; and that in all these ways and more, pension plans make a positive contribution to Ontario's social and economic well-being.

To anticipate the outcome of the detailed review of these assumptions in subsequent chapters: they seem broadly sound. Consequently, I have no hesitation in adopting as the first principle of this report the approach set out in my mandate: *public policy in Ontario ought to maintain and encourage DB pension plans*.

Principle: Create a positive environment for defined benefit pension plans within a voluntary system

Implicit in the Commission's mandate is a further assumption: that our present system of DB pensions is *voluntary*. This assumption explains several features of the present system: employers are not now required by law to provide workers with any form of occupational pension (though the establishment of public sector plans is necessarily authorized by statute); employers may initiate plans for their own reasons or because they have promised to do so in the context of individual or collective negotiations with their employees; and employers are free to amend or discontinue existing plans, provided that they do not violate such promises or infringe the rights of plan beneficiaries.

Moreover, voluntarism not only explains much about the present system, but it also effectively defines the range of options available to reform it. For example, while other countries have experimented with compulsory retirement savings schemes, my mandate does not permit me to recommend substituting some such system for our own. Or to take another example, in evaluating options for reform of the present voluntary system, one criterion, among others, is how reform might influence the exercise by employers of their choice to sponsor or not sponsor plans.

However, while voluntarism is certainly a baseline assumption of our occupational pension system, it is not a principle *per se*. Moreover, while voluntarism is implicitly assumed in the mandate of the Commission, the "maintain and encourage" principle set out above is, by contrast, explicit. How then to square an implicit assumption with an explicit principle? How to "maintain and encourage" DB pensions within a voluntary system? This answer, perhaps, is to adopt a second principle: *public policy initiatives ought to focus on creating a positive environment* in which DB plans will flourish; in which the integrity of such plans, once established, will be protected; and in which the legitimate interests of plan sponsors and active and retired members will be fairly balanced.

Thus stated, the second principle is optimistic: it looks forward to an era in which the benefits of DB plans will be more secure and widespread. It is realistic: it assumes that employers who voluntarily choose to initiate or maintain pension plans want them to operate at acceptable cost, honestly and in accordance with the law and proper standards of administration. And it is necessary: it acknowledges that once voluntarily established, pension plans affect the rights and interests both of their sponsors and of their intended beneficiaries.

Finally, creating a positive environment within a voluntary pension system implies an active role for the state beyond its necessary regulatory functions. The state is particularly well placed to gather and distribute information, to disseminate ideas, to promote dialogue among stakeholders, and to clear away obstacles to and provide incentives for thoughtful innovation. If the state is indeed to perform these important functions, some agency or official must be mandated to lead the exercise. As well, creating a positive environment implies an active role for stakeholders who must be prepared to work with the state and each other in an open and constructive manner.

Principle: Coordinate pension policy with other policy domains and legal–regulatory regimes

In addition to DB pensions, many other kinds of arrangements — public and private, voluntary and otherwise — contribute to the overall income security of older Ontarians. Moreover, many of the positive outcomes associated with DB pensions, such as the promotion of labour force attachment and the accumulation of pools of investment capital, can be, and often are, advanced through public policies that have nothing to do with pensions. Further, as noted above and as explored in later chapters, legal rules originating in other policy domains — notably taxation and bankruptcy — directly or indirectly affect the establishment and operation of DB plans and, more generally, the sustainability of the occupational pension system. And finally, pension law and regulation are intertwined with other public and private regimes, including trust and contract law; family and labour law; and rules and practices emanating from the actuarial, accounting and legal professions.

This intertwining of pension policies and legislation with regimes originating elsewhere underlines the need for *coordination*, the third principle shaping my analysis and recommendations. Clearly, policies governing occupational pensions should, if possible, be designed to produce optimal results in labour and capital markets and to reinforce Ontario's system of income protection for seniors. Just as clearly, the authors of income tax and insolvency legislation should take account of their effects on pension design and administration.

And judges and regulators should be sensitive to the need to maintain coherence and predictability in pension law and policy while drawing on potentially helpful concepts, principles and rules developed in other contexts.

In the end, coordination is likely to require legislative action — but for that very reason, it is especially hard to achieve in Canada's federal system. Some policy domains relevant to pension policy fall under the jurisdiction of provincial governments and others under federal jurisdiction, and within each jurisdiction, some are confided to one branch, agency or department of government and some to another. However, these constitutional and jurisdictional difficulties can be eased, if not overcome, by open dialogue among and within governments, supported by good research, which provides them with a common understanding of the issues. There is room for significant improvement in current arrangements to facilitate coordination.

Principle: Promote cooperation and selective convergence among Canadian pension regimes

Each Canadian jurisdiction is in principle free to enact and apply its own pension legislation. However, many employers operate across provincial boundaries and many occupational pension plans cover employees in two or more provinces, while others cover employees in industries under federal jurisdiction. Cross-Canada harmonization of pension legislation would thus facilitate not only regulation but plan administration.

However, harmonization has not been achieved and the provinces have so far settled for an arrangement whereby regulatory responsibility is assigned to the jurisdiction in which a plurality of active plan members works. For reasons canvassed elsewhere, the current arrangement is less than satisfactory, and the problem remains that regulatory requirements continue to differ from one province to another.

In these circumstances, Ontario ought to minimize the cost and inconvenience to plan sponsors and members by adhering to the principle of *selective convergence*. This principle requires that legislators should inform themselves of regulatory best practices in other Canadian jurisdictions and adopt similar measures in Ontario when such practices appear to be conceptually sound and/or successful in practice. If other jurisdictions decide to do likewise, momentum in the direction of more extensive convergence may develop.

Principle: Ensure the honesty and integrity of the pension system

It is important to ensure the *honesty and integrity* of pension plans and of the pension system as a whole. Beneficiaries are entitled to be treated in accordance with the terms of the instruments by which plans are established and the legal rules by which they are governed. This requires that those responsible for collecting pension contributions, administering pension plans and dispensing pension benefits should act as fiduciaries: honestly, competently, in good faith and transparently. It also requires that those who provide professional advice and services to pension plans should meet the highest applicable legal and professional standards.

Principle: Protect the financial security of pension plans

While employers are under no obligation to establish pension plans for the benefit of their workers, once established, public policy requires that such plans be kept financially secure. The *financial security* principle requires that pension promises should be honoured, subject only to contingencies contemplated by law or set out in the terms of the plan itself.

In the context of DB pension plans, the financial security principle requires at a minimum that workers should know with relative certainty the formula that will determine their future pensions; that both active and retired members should be assured that their entitlements will be maintained at the level promised; and that plan sponsors should make adequate financial provision to honour their pension promises. In the context of multi-employer plans and some hybrid plans, which treat the pension promise as less than absolute, the same principle requires that the circumstances under which entitlements may be compromised should be clearly established by law or in the plan itself, made intelligible to all plan members and invoked by means of fair procedures.

Principle: Balance the financial interests of past, present and future plan members

Adherence to the financial security principle may be jeopardized by developments over which neither plan sponsors nor pension regulators have control, such as a decline in financial markets or new competitive challenges that affect the sponsor's business prospects. On the other hand, their reactions to such developments, even when genuinely intended to protect the plan, may not end up affecting all plan members — past, present and future — in the same way. The permissible extent of differential treatment may be specified in the plan design or in the legal rules that regulate its operation. However, to the extent that it is not specified, plan sponsors, regulators and representatives (if any) of active and retired members should attempt to ensure *balanced treatment* of the interests of all those who have contributed or will contribute to, or are entitled to support from, the plan's assets.

Principle: Ensure predictability and affordability for plan sponsors

So long as voluntarism remains a defining characteristic of Ontario's pension system, the continuation of existing plans and the initiation of new plans depends to an extent on their cost to sponsors being — and being perceived to be — *affordable and predictable.*

Affordability and predictability are not always easily reconciled with each other or with the *financial security* principle, set out above. A sponsor may increase the predictability of its contribution by investing more heavily in assets that yield fixed returns, but these assets tend to be more expensive. Members may favour such investments as well, since the pension fund is more secure, but they may be unwilling to forgo higher wages and benefits in order to induce the employer to make larger contributions. Conversely, in an effort to keep costs affordable, sponsors and plan administrators may seek investments that provide higher returns but that involve enhanced risks that may compromise the financial security principle. And in an effort to keep their costs predictable, sponsors may turn to long-term funding strategies that, at given moments, produce unanticipated "surpluses" or "deficits" — higher or lower levels of funding than strict application of the financial security principle would warrant.

The tensions or contradictions between and within these principles lie at the heart of many of the debates over pension policy, which led to the appointment of this Commission. They are the subject of extensive analysis later in this report.

Principle: Strive for clear, comprehensive, consistent and codified regulations

While contradictions among the principles of the pension system may be inevitable, not all controversies arise from conflicts of principle. Some result from the failure of legislatures to express themselves clearly, of courts to consider or comprehend the full implications of their judgments, or of regulators to properly gauge the extent of their powers and the reach of their mandates. Greater care in the drafting and interpretation of legislation and regulations governing the pension system may help to reduce or avoid such conflicts.

Regulatory texts should therefore adhere to the *clarity* principle. If possible, they should be *clear, comprehensive and consistent* with each other. And, if possible, they should be *codified* in a single authoritative document so that those whose rights and obligations are affected will know the rules by which they are governed, and those who are called upon to resolve differences or adjudicate disputes will know where to find the applicable law.

Clarity if possible, then; but not clarity at any price. The clarity principle has its limits. First, understandings about policy goals or how best to achieve them may change; unforeseen contingencies may arise that cannot be dealt with under existing laws; and updating the law by substituting a new "clear" text for an old one may be a lengthy and difficult process. Consequently, legislators, regulators and decision-makers sometimes prefer broad language, with its potential for ambiguity rather than clarity. Breadth and ambiguity permit incremental changes in the law — adjustments at the margins to meet the changing needs of the pension system without the need for formal amendment.

Second, the clarity principle assumes that all subjects of the law — in this case, pension plans — will be treated alike. However, if, the maxim "one size doesn't fit all" deserves to be treated as a principle (as I next suggest), and if various types of pensions require differential regulatory treatment, "comprehensiveness" and "consistency" in the law are obviously impossible.

Third, clarity may be achieved by drafting legislation that is extremely detailed, and insisting that it be literally construed. This approach has something to recommend it. On the other hand, it is likely to yield pension legislation that, like the *Income Tax Act*, can be read and understood by only a small community of experts; and it may encourage regulators and courts to merely follow the detailed letter of the law rather than to advance its intent and spirit.

Principle: Accept that one size doesn't fit all

Material differences exist among types of pension plans that reflect differences among economic sectors — in patterns of employment, in the various financial circumstances and administrative capacities of plan sponsors, and especially in plan design and governance. Without compromising the principles set out above — the *honesty and integrity* principle and the *financial security* principle, for example — it is important that material differences among plans should be reflected in the details of regulatory requirements. Failure to adjust regulatory norms to accommodate such differences will result in a number of undesirable outcomes: some plans will be more intensely regulated than they need to be, others less; experiments in regulatory strategy will be more difficult to initiate; and innovation in plan design will be discouraged.

Hence the *one size doesn't fit all* principle: in drafting pension statutes or regulations, legislators and regulators should take account of material differences among species of plans. The principle should be invoked only when the differences are indeed "material" to the proposed regulatory variation, only after careful consideration and only prospectively. It should not be invoked after the fact or opportunistically to resolve awkward controversies.

Principle: Regulate fairly, openly, effectively, efficiently and adaptably

Ontario's pension system is too large and complex, and affects too many conflicting private and public interests, to be left unregulated. Hence the need for principles that will define the appropriate approach by the state to its regulatory responsibilities.

The regulatory apparatus of the state should be sensitive to all interests, *open* and helpful to all who need to invoke it, and *fair* in its treatment of all whose conduct is subject to oversight and constraint. Regulatory norms, processes and agencies should be *effective* in achieving their assigned objectives; they should be *efficient* in doing so with the least possible burden on public resources and on the parties regulated by them; and they should be *adaptable* so that they can respond to changing practices, circumstances and expectations. As a corollary, regulatory mandates should be defined with care, and regulatory agencies should be assigned sufficient powers and resources to perform the tasks assigned to them.

Principle: Achieve compliance by graduated regulatory responses

The ultimate objective of regulation is to secure compliance with public policies and statutory requirements. However, a pension system in which compliance depends primarily or exclusively on the actual or threatened use of legal sanctions is unlikely to operate efficiently or effectively, nor are legal sanctions the best way to encourage responsible innovation within an evolving pension system.

Consequently, any strategy designed to achieve compliance should operate according to the principle of *graduated responses*. This principle contemplates that pension sponsors, administrators and service providers will be encouraged to conform not only to law but also to best practices; that plan members should be empowered to safeguard their own rights and interests; that non-compliance with pension plan provisions, legislation and regulations should be proactively detected and forestalled if possible; that persons harmed as a result of non-compliance should be fully and speedily compensated by the wrongdoer; and — as a last resort — that gross negligence, fraud or other serious wrongdoing should be punished with certainty and severity sufficient to deter such conduct in the future.

Principle: Facilitate innovation in plan design

Despite their many attractions, DB plans cover a smaller fraction of the Ontario workforce than they used to, and new DB plans have been introduced rather infrequently in recent years. In order to promote the adoption of such plans by a new cohort of sponsors, *innovation* in the design of such plans should be encouraged or facilitated — not constrained or prevented — by legislators and regulatory authorities. The result of such innovation may be to encourage the emergence of new types of plans that are not, strictly speaking, DB plans, but that are their functional equivalent in the sense that they offer some or all of the advantages traditionally associated with DB plans.

Moreover, those responsible for designing and implementing new types of plans, and for establishing the regulatory frameworks within which they operate, ought to consider how to enable them to respond to changes in the external environment, in the circumstances of the sponsor, and in the composition and needs of the plan membership, while respecting the rights and interests of all stakeholders.

Principle: Promote honest, prudent, knowledgeable, efficient, successful plan administration

Even the best-designed plans, subject to the most effective regulatory oversight, are unlikely to succeed unless they are well-administered. The hallmarks of good pension administration are *honesty, knowledge of the pension system, prudent management of the plan's assets* and *efficiency*. Plan sponsors, administrators, active and retired members, service providers, professional advisors and regulators should all be committed to achieving a high quality of plan administration. Of course, lay persons and trained pension professionals may exhibit these qualities in different ways and to different degrees, but individuals in both categories should ensure that they receive the training necessary to achieve the high standards expected of them.

Principle: Ensure clarity and transparency of plan administration

Despite attempts to implement the clarity principle, most pension plans, the documents that initiate them, and the legal rules that regulate them tend to be complex, arcane and intelligible only to experts and professionals. As a practical matter, few plan members are likely to be able to determine for themselves the extent either of their entitlements or of the contingencies that might curtail those entitlements. However, if plan members are unable to make such determinations, they are in danger of being exposed to unwarranted risks or deprived of their entitlements without their knowledge or consent. It is therefore important that the nature and extent of the pension promise be *clearly* conveyed to members of the plan when they join it, when that promise is altered, and when they are in a position to benefit from it by drawing their pensions or leaving the plan.

Because most plan members lack the expertise to deal with information about their pensions, even if transparent, plan administrators should be obliged not only to provide such information to regulators but also to *communicate it directly to members in easily understood language* at regular intervals, upon request or promptly following unusual developments that may affect them positively or adversely. And because the plan's prospects may fluctuate from time to time, it is also important that pension administration be conducted in a *transparent* manner, so that regulators will be able to perform their functions and plan members and their representatives will be able to assess their position in light of reliable information and, if necessary, take action to protect their interests.

Finally, pension regulators ought to ensure that the transparency principle is respected not only by plan administrators, but by themselves. Responses by regulators to enquiries and complaints ought to be quick, courteous and comprehensible to the recipient.

Principle: Encourage voice and participation by members

Most Ontario pension plans are sponsored and administered by single employers, even though most workers are now enrolled in other types of plans, such as multi-employer or jointly sponsored plans. In single-employer self-administered plans, virtually all important decisions are made and implemented by the sponsors, or their nominees or agents, albeit within the framework of a collective agreement if their employees are unionized. However, unilateral decision-making by the employer-sponsor gives rise to two concerns: that unilateral power may be abused, whether intentionally or otherwise, and that plan administrators or sponsors may take good faith decisions that adversely affect plan beneficiaries.

These concerns each evoke a response. The first — captured in several previous principles — is to ensure that power is exercised transparently, within the bounds of clear norms and/or detailed rules, and subject to vigilant regulatory oversight. The second is to facilitate and encourage participation of those affected by decisions in the process that produces the decisions.

These two responses appear to be complementary. On the one hand, DB plans, which are administered by the sponsor, are subject to fairly strict regulation by the state. On the other, regulatory requirements may be somewhat less rigorous when decision-making is shared between sponsors and active and retired plan members, as in jointly sponsored plans, or assumed by the members themselves, as in some multi-employer plans, or when members are legislatively guaranteed the right to participate in certain kinds of decisions, such as the distribution of surpluses following plan wind-ups.

These observations seem to suggest that current pension law may tacitly acknowledge a principle*: if active and retired plan members participate in decisions affecting their interests, the intensity of legal regulation may be somewhat relaxed*. Whether or not this is so, it is a principle whose potential relevance to DB plans will be carefully explored in Chapter Eight.

1.6 The Organization of This Report

The next two chapters establish a context for subsequent analysis and recommendations. Chapter Two documents the role pensions play in Ontario's economic and social policy; Chapter Three investigates the specific problem of declining coverage in our pension system. Chapters Four, Five and Six all deal with difficult financial issues: the funding of pension plans, the effect upon them of corporate restructuring and worker mobility, and the consequences of plan failure, respectively. Chapters Seven and Eight deal with the regulation of pension plans by the state, and governance issues confronting sponsors and members. Finally, Chapters Nine and Ten look forward to new ways of promoting innovation in pension design, and to new strategies for keeping pension policy up-to-date.

Finally, for readers interested in identifying the sources of information and analysis that underlie the main text, the Commission has prepared a Technical Annex, which provides the equivalent of footnotes or endnotes.

CHAPTER TWO – WHAT PENSIONS DO

2.1 Introduction

In this chapter, I describe the effects of Ontario's defined benefit (DB) occupational pension system on a number of policy domains: the provision of retirement income security, the promotion of savings, the functioning of labour markets and the province's economic well-being in general.

Describing these effects ought to be a straightforward task. Unfortunately, it is not. The data on which such a description must be based was neither readily available nor particularly reliable — a complaint first made by a Canadian pension commission in 1912, and repeated by virtually every commission since. Commission staff and contract researchers — notably Richard Shillington of Informetrica Ltd. — made extensive efforts to obtain, integrate and verify the relevant data. However, though now likely as good as it is going to get, the data available to the Commission remains more uncertain than it ought to be in such an important field of public policy. There are several reasons for this.

First, many of the standard sources of pension data for Ontario were simply not reliable. The three principal agencies that collect Ontario pension data — the Financial Services Commission of Ontario (FSCO), Statistics Canada (StatsCan) and Canada Revenue Agency (CRA) — each does so for its own purposes and from a somewhat different perspective. FSCO, the primary agency, regulates not just pension plans but other kinds of financial institutions. Consequently, though its executive head, the Superintendent, is authorized under the *Pension Benefits Act* to "conduct surveys and research programs and to compile statistical information related to pensions and pension plans," FSCO does not see itself as having the mandate or resources to collect or analyse data not directly related to its regulatory functions, or to support policy making within a broader social policy framework. It is further hampered by its reliance on cost-recovery financing, which inevitably limits its ability to develop a substantive policy research capability. As a result, FSCO simply does not collect a great deal of data that would be useful for policy making and, unfortunately, when data sets do exist, they are sometimes erroneous, miscoded or intermittent.

StatsCan and CRA — both federal agencies — produce an array of pension data. However, StatsCan relies in part on FSCO data, whose limitations are mentioned above. Moreover, because of differences in definitions and methodology as between FSCO and StatsCan, it is often difficult for third parties such as academic researchers or policy analysts to integrate studies produced by these two bodies. For similar reasons, data generated by CRA is not always consistent with data from StatsCan. For example, the StatsCan definition of a multi-employer pension plan (MEPP) differs both from that of FSCO and of CRA. This has resulted in coding errors by the other agencies, which in turn makes analysis of the long-term growth of these important plans very difficult. Likewise, the definition of pension plan members in Ontario fails to take account of the fact that a worker may be contributing to one plan while being a deferred member of several others.

And finally, neither federal agency produces data sets that can be directly and easily used by Ontario policy analysts. For example, readily available federal data often does not distinguish between workers resident in Ontario whose employment and pensions are regulated by Ontario legislation, and those whose employment and pensions are regulated by federal legislation. The latter group is considerable: it includes Ontarians employed in federally regulated businesses such as banks, railways, telecommunications and airlines (whose pension plans are regulated by the Office of the Superintendent of Financial Institutions), as well as members of the federal public service and the armed forces who happen to reside in Ontario. Nor does the available data readily permit measurement of the sectoral or occupational distribution of workers enrolled in pension plans.

How do these data difficulties affect the Commission's work? I cite three examples among many.

First, even basic information concerning the number of workers contributing to, or retirees collecting benefits from, DB pension plans regulated by the province's *Pension Benefits Act* could not — and still cannot — be provided at a proper level of reliability.

Second, Chapter Three explores the extent and cause of a decline in DB pension coverage, one of the key issues confronting the Commission. However, it is almost impossible to determine coverage by economic sector for plans under Ontario jurisdiction. FSCO does not track sectoral coverage on a consistent basis. StatsCan does do so, but its confidentiality and suppression policies preclude publication of much of its data. Consequently, only with the greatest difficulty has the Commission been able to assess the straightforward claim that the decline in employment in the manufacturing sector accounts for a significant proportion of the decline in overall pension coverage. And if it is difficult to reliably link occupational pension plan coverage to the social and economic characteristics of plan members on a current basis, it is almost impossible to do so retrospectively.

Third, the Commission has tried to ascertain the extent to which DB coverage is being replaced by defined contribution (DC) coverage rather than by no coverage at all. However, statistics on retirement income are not sufficiently disaggregated by source to enable the Commission to measure precisely the proportion of income attributable to different types of pension plans. It is therefore unable to do more than approximate what might be the future consequences for Ontario's income security policies and its economy of the current downward trend in DB coverage.

In short, the data developed by the Commission to support the analysis in this and succeeding chapters is the best that could be managed (and more accurate, I believe, than data used in previous pension studies in Ontario or Canada). However, it is still too approximate, still inferior to data used to support studies and regulatory activity in some other jurisdictions, and still inadequate as the basis for future pension policy development.

This last point bears repeating. Ontario's pension system can be strengthened only if we proceed from an informed and careful diagnosis of the difficulties of the present system. But no such diagnosis is possible if professionals, researchers and advocates lack the tools to undertake statistical research. In Chapter Ten I make several recommendations that should improve their situation. For now, I merely note that Ontario's Ministry of Finance has already begun to enhance its capacity to collect and analyse pension data.

2.2 The Contribution of Occupational Pensions to Ontario's Retirement Income System

Pension systems should not only alleviate poverty among the elderly but also prevent a significant fall in the living standards of workers upon their retirement. Success in achieving the latter objective is usually measured by reference to a suitable, but much-debated, "replacement rate" — the substitution of retirement income for wages from employment.

In Canada, as in many other countries, the pension system comprises both private and public elements. Private elements include various forms of savings, some of them tax-sheltered, such as Registered Retirement Savings Plans (RRSPs), the recently initiated Tax Free Savings Accounts (TFSA) and especially occupational pensions provided voluntarily by employers or unions, or under their joint sponsorship. Public elements include the federal Old Age Security (OAS) program, the Guaranteed Income Supplement (GIS), the Canada/Quebec Pension Plans (C/QPP) and other schemes established by the provinces.

Relative to many OECD countries, Canada's public retirement income programs are quite modest. As a result, occupational pension plans and other forms of private savings play a more important role in providing retirement income security and in achieving a suitable replacement rate. Moreover, the public and private systems have become tightly integrated so that clawbacks at a rate of 50% are built into the design of both the federal GIS and the Ontario Guaranteed Annual Income System (GAINS). Thus, integration reinforces the significant role accorded occupational pensions in retirement income policy.

The difficulty is, however, that in jurisdictions such as ours, with voluntary private pension systems, coverage of occupational pension plans has never exceeded 50% of the workforce. In fact, in Ontario, while the absolute number of workers with pension coverage has been increasing, the percentage of those with coverage has been declining slowly since the 1970s and now stands at 34.7% of the paid labour force under provincial jurisdiction — somewhat below the Canadian average (including federal workers) of 38.5%. Nonetheless, the absolute numbers are still impressive: approximately 2.18 million Ontarians are covered (1.76 million by plans under provincial jurisdiction; 420,000 by plans under the jurisdiction of the federal government or some other province) and a further 1.0 million Ontarian retirees are collecting pension benefits (850,000 under Ontario-regulated plans, the balance under plans regulated by other Canadian jurisdictions). These workers and retirees, together with their families and dependants, constitute a significant presence in virtually every community in Ontario.

In general, average retirement incomes and replacement rates have improved since the early 1970s. As a result, the financial security of Canadian seniors has improved considerably relative to what it once was, and relative to that of seniors in many OECD countries. However, this significant achievement for Canadian social policy owes at least as much to the maturation of the C/QPP system, and to the introduction of other age-related public support systems, as it does to occupational pension plans.

Moreover, the experience of different groups of retirees varies, depending on the extent to which their retirement incomes are derived from public as opposed to private plans. Private retirement programs — occupational pension plans and RRSPs — constitute a much larger proportion of the incomes of middle- and high-income retirees than of low-income retirees. Longitudinal studies show that Ontario retirees in the most affluent quintile rely on occupational plans and private savings for 41% of their income, and on public plans for only 16%. By contrast, retirees in the poorest quintile receive 57% of their income from the public system and only 21% from private pensions and RRSPs. Indeed, most lower-income retirees have nothing more than public plans to rely on. Only about 25% of families in the poorest quintile had an occupational pension, and only 2% of families in this group had two.

These contrasting positions are made more extreme because wealthier Ontario families tend to have resources in all areas required for the provision of retirement income security: home equity, retirement assets and personal investments. They are also more likely to have more than one private pension plan: for top-quintile earners, roughly 80% of prime-aged families had at least one occupational pension plan, and at least 40% of them had two. They are also more likely to have some post-retirement employment earnings, being generally well-educated and often self-employed. And finally, wealthier retirees also receive public pensions, although as noted, these are subject to being taxed or clawed back.

Not surprisingly, then, since the early 1980s, the capacity of wealthier and lower-income families to meet their retirement income needs has been diverging. While average retirement savings of couples grew during the period 1986–2004, most of this growth was attributable to higher-income earners. For those in the bottom quintile, savings were stagnant — perhaps because they were obliged to spend their relative meagre earnings for current needs. In sum, there has been an increase in inequality of retirement income that mirrors the long-term trend toward greater inequality in earned income.

This inequality, finally, is not distributed randomly among different demographic groups. Our research shows that, as is the case with wages, males have higher retirement incomes than females, although the gap is closing. And, as noted in the next chapter, recent immigrants are more likely than others to find themselves with little retirement income beyond what the public system provides — and even the public system does not provide them with full benefits. It seems likely, too, that members of visible minorities are similarly disadvantaged.

What is the position of seniors who have no occupational pensions and must rely entirely on public schemes for their retirement income? Today, a single 65-year-old would receive no more than $18,000 a year from public sources. This person would be living just on the cusp of poverty, according to several accepted benchmarks. In terms of income replacement ratios, public plans do, on average, provide the lowest quintile of retirees with income benefits greater than 100% of their pre-retirement earnings throughout their retirement. However, about 20% of this group — mostly single women — had replacement ratios below 80% by the time they were 70 years old, which would mean they too are living in poverty. Longitudinal studies show little change in these replacement rates over time.

Furthermore, in more recent years, with the maturation of the C/QPP, the most rapid source of income growth for older Canadians has been not from public plans but from occupational pensions and annuities, often purchased by private savings, including RRSPs or DC plan lump sum payouts. Several studies attest to the growing relative and absolute importance of occupational pension plans and RRSPs in the provision of retirement income security. Thus, in 1984, Canadian seniors received 76.8% of their income from public plans and 23.2% from occupational pension plans and RRSPs; in 2004, they received 59.8% from public plans and 40.2% from these private sources. Whether this trend will continue in Ontario in light of the difficulties in its pension system, described in Chapter Three, is a question that requires careful study.

To conclude, the public and private elements of our retirement income system are related, even integrated, in certain ways. But while the public pension system does mitigate the worst effects of income polarization, patterns of private retirement saving (which include occupational pensions and RRSPs) are determined by, and therefore tend to reproduce and possibly exacerbate, the disparities in income that Ontarians experience during their working lives.

2.3 Occupational Pensions as a Strategy to Promote Savings

Defined benefit plans — which account for about 80% of all occupational pension coverage — represent only one of several possible strategies of saving for retirement. How do they compare with the alternatives?

Since they operate through collective pooling of contributions and assets over a long period, DB plans in effect provide some degree of security or "insurance" against many of the risks confronting retirees, such as outliving their savings (the "longevity risk") or experiencing poor investment returns (the "investment risk"). Because DB pensions spread these risks among all plan members, young and old — even across generations of plan members — they help to ensure that retirees will have a source of income until their death. Some DB plans provide disability or other ancillary benefits and some provide *ad hoc* or formulaic protection against inflation. Such advantages are not normally available to individuals enrolled in DC plans or those who by choice or necessity save for their own retirement. In addition, DB plans — especially large plans — are highly cost-efficient in terms of their administration and fund management, and provide members with a level of investment expertise that few individual savers themselves possess. Indeed, studies suggest that large DB plans produce significantly higher net investment returns than other savings vehicles, when service costs and fees are taken into account.

To be sure, DB pension plans have been criticized as "paternalistic" because workers cannot "take control" of their own money or choose their own investments. However, studies have frequently shown that workers seldom know what benefits they have a right to receive, let alone how their pension fund actually works. Even when given individualized investment choices, as are sometimes available under DC plans, they often turn out to lack the financial knowledge and skills necessary to optimize their investment returns. And, of course, by contrast with members of DB plans, DC plan members must not only manage the investment risk, but confront the longevity risk as well.

Finally, DB plans are not only collective but, quite often, mandatory for everyone employed in a workplace that has such a plan. This is a positive feature of occupational pension plans. Study after study confirms that, given the choice, people tend not to save enough for retirement, if indeed they save at all. Researchers of the "behavioural finance" school label this tendency as "un-knowledgeable," "apathetic" or "myopic" — terms that apply not simply to those with low incomes (who are under strong pressures to spend what they earn) but also to those with significant capacity for savings. No doubt that is why some jurisdictions — notably Australia — have moved to universal, mandatory occupational pension systems with opt-out provisions. Under their systems, all employers must contribute but, typically, contributions remain voluntary for employees, with incentives provided by the government in the form of matching payments. In the United States, whose *Pension Protection Act* of 2006 encourages but does not require employers to initiate plans with opt-out provisions, preliminary research shows that most workers are still not saving nearly enough to support themselves in retirement.

These features of DB plans — security, cost-efficiency, investment expertise, mandatory membership — strongly recommend them as a savings strategy. Of course, DB plans are not perfect. They depend crucially on the willingness of the employer to sponsor a plan in the first place and to continue to support it in the face of a challenging business environment and rising pension costs. Plans may fail due to poor administration, the insolvency of the sponsor or some external cause. They may suffer temporary financial reverses. And they may not — and often do not — provide adequate protection against inflation.

But for all their shortcomings, DB plans appear to be, like democracy, the worst system of retirement savings — except for all the others. Those shortcomings are addressed in subsequent chapters. So, too, is the need to enhance the understanding by plan members of the risks and benefits associated with different savings strategies and, if they are covered by a DB plan, of what that plan does and does not offer them.

2.4 The Effect of Occupational Pensions on Labour Markets

Occupational pension plans are not simply part of the larger system of retirement income security and an attractive vehicle to encourage savings — they are also a significant influence on labour markets.

Employers provide pensions because they believe that doing so helps them to attract and retain the workers they need and want. And indeed, pensions do seem to produce the effects imagined and intended by employers: workers with pensions stay in their jobs longer than those without. However, the precise cause-and-effect relationship between pensions and job tenure is unclear. On the one hand, because the design of many DB plans is back-loaded, workers know that they must stay to receive the full value of their pension. On the other, workers with pensionable jobs may be reluctant to leave them because of the other non-pension benefits typically associated with such jobs. In fact, studies have shown that workers with pensionable jobs enjoy an overall remuneration premium of up to 29% over other workers. Nor is this conclusion counter-intuitive given that pensions are most commonly provided in larger workplaces and in unionized workplaces, both of which also tend to provide higher levels of wages and benefits.

Paradoxically, pensions can be used not only to reinforce job tenure but also to facilitate its termination. This may happen in several ways. First, the availability of a pension requires workers and employers to address the issue of a “normal” retirement age, even though mandatory retirement policies are now unlawful in Ontario and most Canadian provinces. Second, pensions may be used strategically by employers to reduce their workforce by providing early retirement incentives to redundant workers. And third, as employers begin to confront anticipated shortages of skilled labour, they may decide to use pension plans as one element of a flexible retirement strategy that would allow workers approaching retirement to reduce their hours of work gradually rather than all at once, and to maintain the level of their earnings through some combination of wages and pension benefits.

Despite all the positive contributions of DB plans to labour markets, however, the fact that they tend to bind workers to their jobs has also been the subject of adverse comment. Portability is the crucial issue. Workers are understandably reluctant to leave their DB pensions stranded behind them in order to move on to new jobs where their skills might be in higher demand, their productivity might be enhanced and their overall rewards might be greater. This reluctance might diminish if DB pensions were fully portable. However, they seldom are — a situation that has given rise to strikingly different critiques. On the one hand, as early as 1961, the Ontario Committee on Portable Pensions recommended the establishment of an agency that would facilitate portability. Subsequent studies have made recommendations to the same effect. On the other, proponents of flexible labour markets point to DB pensions as a factor contributing to reduced labour mobility and therefore inefficiency, as compared to DC plans, which present no obstacle to movement. (Ironically, as Morley Gunderson points out in his study for the Commission, DB and DC plans are both associated with reduced quits and lower turnover rates.) In Chapter Five, borrowing from the 1961 Commission's recommendations, I review possible arrangements that might both preserve labour mobility and enhance the portability of DB pensions.

As to more general labour market effects, some stakeholders, particularly in manufacturing, argued in their submissions that occupational pensions represent a significant cost that Ontario employers can ill afford in an era when global competition, technological innovation, the high Canadian dollar and other developments are all generating pressures to lower compensation costs. Gunderson's study suggests possible limits to this argument. As he notes, "pensions can have important incentive effects that can be a part of strategic human resource planning on the part of firms…" Presumably the sacrifice of these effects must be reckoned as at least partial offsets to any savings gained by reducing pension costs. Moreover, as he also points out, pensions form part of a "total compensation package;" if employers reduce or eliminate pensions, market forces may return some or all of the savings employers anticipate to workers in the form of wages or non-pension benefits.

This is not a debate that can be resolved in the present context, or indeed elsewhere. Conditions change; theories proliferate; the evidence is likely to remain inconclusive. There is no doubt that Ontario's manufacturers and other employers are experiencing significant competitive pressures, and that they will try to contain labour and other costs — including those associated with pensions. This they have every right to attempt to do, especially in the context of a voluntary pension system. But whether they will succeed, and whether changes in pension preferences, provision and policy can, will or should assist them in restoring their competitive position over the long term is far from clear.

2.5 Occupational Pensions and the Economy

Pension plans have enhanced the dynamism of Ontario's economy in at least three ways: through the investment of their funds; by increasing the purchasing power of pension beneficiaries; and by reducing the reliance of older Ontarians on tax-supported income supplements and needs-related, in-kind benefits. However, as funds mature, as the proportion of Ontario workers enrolled in occupational pension plans declines, as the percentage of retirees with such pensions dwindles, and as older people come to represent a growing segment of the general population, each of these economic effects is likely to change significantly — and not for the better.

2.5.1 Pension funds as investors

Canadian pension funds, with over $950 billion of Canadian assets as of 2005, are the country's second largest source of capital after the chartered banks. Funds based in Ontario-regulated plans account for some $380 billion, 40% of the total. At the end of the second quarter of 2006, according to Statistics Canada, stocks and equity funds accounted for 39% of pension fund assets; bonds and bond funds, 32%; real estate, 7%; short-term investments, 4%; mortgages, 1%; and other assets, 17%. Pension funds are thus a prominent feature of Ontario's financial landscape.

The investment profile of pension funds tends to vary according to plan size. The larger plans, in particular, tend to be a major presence in the financial industry, promoting new financial strategies, institutions and products, as well as improved corporate governance practices. These funds often hire their own in-house investment staff, and possess the resources and long-term investment horizons that enable them to invest in alternative asset classes such as private equity, real estate and public infrastructure. While less liquid, these assets tend to provide higher rates of return. Indeed, a few large plans have established their own investment companies or departments to handle private equity projects; some pool funds through partnerships set up in cooperation with other plans; and yet others invest through more conventional commercial partnerships.

According to some estimates, only plans with more than $10 billion in assets are able to operate across the full investment spectrum. While there are only five such plans in Ontario, they collectively account for 35% of all active plan members under Ontario jurisdiction. By contrast, small- and medium-sized pension funds — the vast majority of plans — generally lack the infrastructure, resources, expertise or inclination to undertake similar portfolio diversification on their own account. As a result, they tend to purchase standard financial products; pay significant fees to financial intermediaries, advisors and service providers; and, in consequence, generate less favourable returns. This discrepancy in market behaviour and financial results between large and small plans prompt some suggestions later in this report.

Pension funds are able, and sometimes willing, to provide "patient capital." Both the federal and provincial governments have therefore expressed interest in persuading them to invest in infrastructure projects such as water and waste disposal facilities, hospitals, schools, highways and transit systems, courthouses and correctional institutions. Public–private partnerships sometimes serve as the vehicle for pension fund investment in these infrastructure projects, although this approach is controversial in some circles. The Bank of Canada recently suggested improvements in the framework governing the financing of public infrastructure projects, with a view to encouraging even more extensive investment by Canadian pension funds in such projects.

Finally, the firms that manage Canadian pension funds, many of which are located in Ontario, produce significant earnings for their clients through trading gains, dividends and interest payments on longer-term investments. These pension managers often become successful wealth-generating organizations in their own right, a significant presence in Ontario's financial services sector and important contributors to its economy.

2.5.2 The impact of pension funds on the purchasing power of retirees

While the data is far from reliable, and reaches back only to the beginning of this decade, it suggests that occupational pensions account for about 20% of the overall purchasing power of retired individuals and couples — their largest single source of income. To be sure, this percentage is not constant among age cohorts; it differs among retirees with different overall levels of income and is lower for those over 85. However, income from occupational pensions amounting to some $36.1 billion in the aggregate clearly represents an important component of the income available to older Ontarians. Moreover, expenditures by retirees of this large sum on goods and services generate multiplier effects that, in turn, benefit businesses, workers and communities across the province.

2.5.3 The relationship between occupational pensions and government revenues and expenditures

As Chapter Three explains in greater detail, occupational pension coverage has been declining for several decades. If this decline continues, what will be the effects upon the province's financial health?

On the one hand, the existence of occupational pension plans reduces the potential cost of publicly funded income support systems, which would otherwise come under pressure to pay higher benefits and, likely, to cover a larger proportion of retirees. Studies undertaken for the Commission by Richard Shillington and Keith Horner show how the clawback provisions of the federal GIS and provincial GAINS programs presently operate to accomplish this result. As a corollary, if fewer clawbacks occur due to declining pension coverage, these programs are likely to cost taxpayers more. On the other hand, benefits paid by occupational pension plans are taxable income in the hands of retirees and thus make a positive contribution to the fiscal health of the province. The shrinkage of pension coverage represents a potential threat to this revenue source.

It is sometimes suggested that personal RRSPs can and will fill the void in retiree income left by the diminishing coverage of occupational pension plans. However, the Horner study suggests that this is unlikely to be the case, as RRSP contribution rates seem to be declining in tandem with the decline in occupational pension coverage. The consequences of a decline in pension coverage must therefore be confronted head on.

Horner has modelled the impact of a 10% decline in occupational pension coverage from the current level of just under 35% to about 31.5%. He analyses two scenarios, one where the 10% decline is not replaced by other savings, and one where increased RRSP contributions offset the decline in pension income by one-half. He suggests that by 2030, a combination of reduced tax revenues and increased benefit expenditures in public income-support programs would cost the provincial and federal governments together between $819 million and $1401 million, depending on which assumption is used concerning RRSP contributions. Horner also notes that the strongest effects are likely to be those on tax revenues — nearly 70% of the total. By 2030, the impact of a 10% pension decline in current pension coverage would yield a decline of about 0.7% in the net cash flows of the federal and provincial governments combined. These are non-trivial consequences.

Finally, mention must be made of a development that may perhaps mitigate the predicted negative effects of declining pension coverage. Due to the increased labour force participation of women, the overall proportion of adults in “paid work” in Canada has increased in recent decades. Conceivably, the resulting increment in household earnings and savings could offset the decline in pension income, allow retirees to achieve desired income replacement rates even without pensions and therefore insulate public income support programs from the pressures forecast above. Time — and more and better research — will tell.

2.6 Conclusion

In light of the generally positive contribution of occupational pensions to various domains of Ontario’s social and economic policy, to its workplaces and capital markets, and to its financial well-being, it seems both odd and unfortunate that this chapter must end by noting that the system has for many years experienced a long, slow decline. The next chapter examines the extent, and possible causes and consequences, of that decline.

CHAPTER THREE – THE DECLINE OF ONTARIO'S OCCUPATIONAL PENSION SYSTEM

3.1 Introduction

For at least 20 years — perhaps 30 — the percentage of the province's workforce enrolled in occupational pension plans has been declining. This chapter analyses the extent and nature of that decline, its causes and its consequences. Such an analysis is essential not only in order to determine what, if anything, can or should be done to arrest or reverse it, but also to ensure that recommendations concerning other issues are made with a full appreciation of how they are likely to affect coverage.

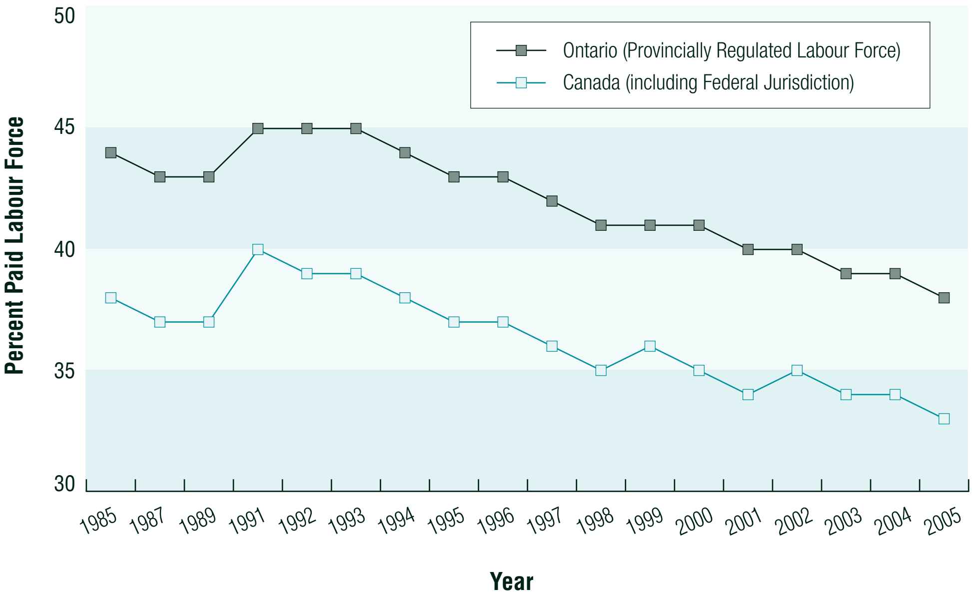
Accurate data is particularly important in measuring and interpreting the decline in pension coverage. However, for reasons outlined in Chapter Two, this chapter must begin with a caution to readers: despite the extensive attempts of Commission staff and consultants to enhance its accuracy, all data cited in this and other chapters should be treated as somewhat suspect. A special problem in the current chapter is that, from time to time, I have had to rely on data concerning not just workers under Ontario jurisdiction, but all Ontario workers covered by any sort of pension plan (including those enrolled in plans under the jurisdiction of the federal government or other provinces). Occasionally, indeed, I have had to draw implications from Canada-wide statistics. When I had to use other than Ontario jurisdiction data, I have signalled this departure in the text.

3.2 The Extent and Nature of the Decline

3.2.1 The decline in occupational pension coverage: Some basic facts

As Ontario's workforce has expanded dramatically over the past 20-odd years, so too has the membership of occupational pension plans. In fact, as of 2005, about 300,000 more Ontarians had workplace pensions than in 1985. However, plan membership has grown much more slowly than the workforce itself and as a result, the percentage of workers covered by occupational pensions has fallen. Figure 1 shows the erosion of pension coverage over this period from a high point in 1985 of just under 40% of Ontario workers to about 34.7% by 2005 — noticeably below the Canadian average of about 38.5% in the same year (the Canadian average includes federal jurisdiction workers). While the decline in coverage has been gradual rather than sudden, it is still substantial. And it may get worse: many observers — rightly or wrongly — predict a further significant decline in defined benefit (DB) coverage in the near future.

Figure 1: Ontario-Canada; Occupational Pension Plan Coverage by Ontario Plans as a Percent of the Paid Labour Force, by Regulating Authority



Source: Informetrica, 2007 and OECP

Pension coverage is concentrated in specific sectors of the labour force and economy, especially in unionized workplaces. The Commission's research shows that some 76% of unionized workers are **active** members of occupational pension plans, as compared with 28% of non-union workers. And not only have unions generally gained pension coverage for their members, they have often secured better pensions and pension-related benefits for their members than workers in non-union enterprises typically enjoy. These benefits include indexing, portability and long-term disability, as well as coverage for both part- and full-time workers.

There is a similarly strong correlation between pension coverage and large workplaces. Large employers with the capacity and financial resources to initiate and administer sophisticated human resource policies often make use of pensions to recruit and retain workers. In workplaces with more than 1,000 employees, pension coverage runs at about 60%; at the other end of the continuum, for workers in small enterprises with fewer than 20 employees, the coverage rate is 10%.

Coverage rates also differ considerably between the private sector on the one hand, and the broader public sector (provincial public service, schools, colleges, universities, hospitals, municipalities and Crown agencies) on the other. As of 2005, about a million Ontario private sector workers were enrolled in pension plans regulated by the Financial Services Commission of Ontario (FSCO), a figure that has remained fairly steady for about 20 years. However, because of the substantial growth of the labour force, the extent of private sector pension coverage actually declined during this period — from about 32% in 1985, to 25% in 2005. By contrast, during the same 20-year period, plan membership in the broader public sector in Ontario grew from 480,000 to just over 700,000 members. The coverage rate in the public sector fluctuated during this period, but stood at about 78% in 2005.

As these figures suggest, the gap between public and private sector coverage has grown considerably, and public sector membership now accounts for a disproportionate share of the total. Although the private sector accounts for about 81% of all workers, it contains only about 60% of active plan members. On the other hand, the public sector, which accounts for some 19% of all workers, contains about 40% of active plan members. And one more fact whose significance appears in due course: public sector pension plans are relatively small in number (less than 2% of all plans), but they tend to be much larger than their private sector counterparts.

Linking all of these observations, it might fairly be said that the most financially secure workers — those who enjoy permanent, full-time employment, union representation and high earnings, and who work in large or public sector workplaces — are also most likely to belong to DB plans. Conversely, those who are the least secure — non-union workers who have part-time, temporary or contingent jobs, receive lower pay and are employed in small workplaces in the private sector — tend to have little or no access to occupational pensions.

While, for reasons discussed below, a decline in coverage has been the dominant tendency over the past 20 years, one important improvement in pension coverage stands out: coverage rates for men and women are now almost identical. However, significant disparities in coverage remain among other groups.

3.2.2 Changes in plan governance and design

The decline in overall occupational pension coverage has been accompanied by significant changes in plan governance and design. The general tendency of these changes has been in the direction of joint sponsorship and funding and, in some cases, joint governance as well, particularly in the public sector. The significance of this shift is canvassed in later chapters.

As of March 2007, just over 8,000 pension plans were regulated by FSCO. About 1,800 are so-called individual pension plans (IPPs) — that is, plans with fewer than 10 members. These plans primarily enrol senior executives and do not represent a significant proportion of overall coverage. Of the remainder, just over 6,000 plans are sponsored by a single employer (single-employer pension plans, or SEPPs), while 127 are multi-employer pension plans (MEPPs). Membership overall is almost evenly balanced between these two types of plans: 55% of plan members are enrolled in SEPPs, 45% in MEPPs.

The growing importance of MEPPs within the system partly reflects their historical origins in sectors such as construction and the garment trades, which were populated by a large number of small and sometimes ephemeral enterprises. In these sectors, workers tended to look to their union, rather than to their employer, for pensions and other benefits. Typically, MEPPs in these sectors were funded entirely by negotiated employer contributions, but governed either by unions alone, or by some combination of union and employer trustees. In more recent times, however, unions have managed to launch new MEPPs in sectors of private employment outside their traditional base, and even more importantly in terms of overall coverage, in the broader public sector.

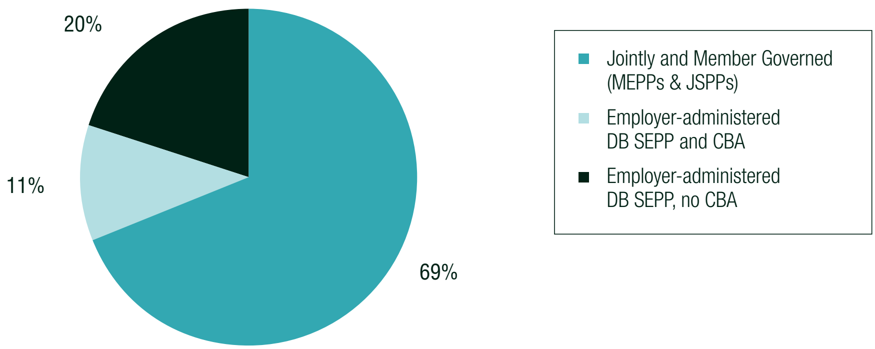
MEPPs are not the only plans that contemplate the participation of worker representatives in governance. A 2005 amendment to the *Pension Benefits Act* authorized the establishment of jointly sponsored pension plans (JSPPs), most of which are also MEPPs in the colloquial if not the regulatory sense. Current JSPP enrolment is about 600,000 workers, or 35% of all active plan members. While in principle both MEPPs and SEPPs can be jointly sponsored, and may be located in either the public or private sector, all existing JSPPs are in fact extremely large multi-unit public sector plans.

Last but not least, an important shift in plan design has been the growth of defined contribution (DC) plans. As I explained in earlier chapters, the precise nature and extent of the growth of DC plans is difficult to track with available data. However, I can say that in 1985, about 8% of active members belonged to DC and composite plans — a figure that grew to 18% by 2005. While this represents a significant movement from DB to DC plans, it is far less dramatic than the movement that occurred during this period in the United States and the United Kingdom. Thus, DB plans continue to dominate the Ontario occupational pension landscape.

3.2.3 Voice and participation

As noted above, and as depicted in Figure 2, most DB plan members (80%) are represented by unions, and of those, a significant majority (69%) are enrolled in plans that are either jointly sponsored and governed (JSPPs), or are governed by boards of trustees, at least half of whose members must be union nominees (MEPPs). Consequently, either indirectly through the negotiation of a collective bargaining agreement (CBA), or directly through their representatives on boards of trustees, active plan members typically have an opportunity to influence plan design and decision-making. Only about 20% of DB active plan members are found in workplaces in which the employer both sponsors and administers the plan.

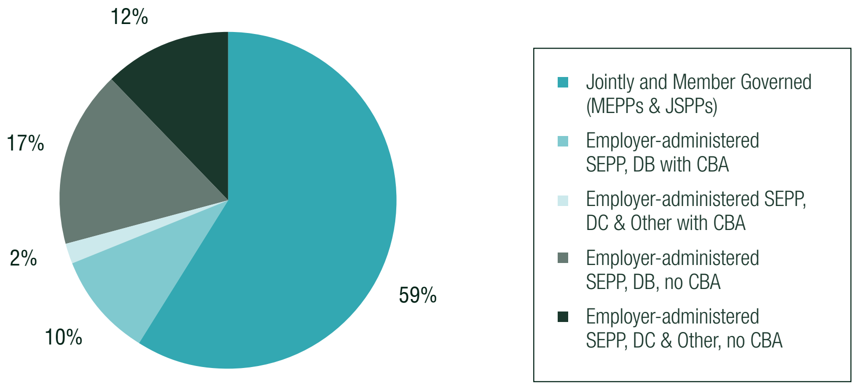
Figure 2: Active Members of Active Defined Benefit and MEPP Plans, by Collective Bargain Agent, 2006 (not including DC & Other)



Source: AIR 2006, OECP

Moreover, as Figure 3 shows, some form of worker voice in governance remains a dominant characteristic of the entire occupational pension system, even when DC and other types of plans are taken into account. Some 71% of all active plan members are found in unionized workplaces; only 29% are found in workplaces where the sponsor unilaterally initiates and administers a DB, DC or other type of plan.

Figure 3: Active Members of Active Plan by Plan Type, Benefit Type (DB, DC & Other) and Collective Bargaining Agent, 2006



Source: AIR 2006, OECP

This distribution of active plan members is significant because, to a large extent, the PBA assumes a rather different set of arrangements. The paradigmatic pension plan under the PBA is the SEPP, which many assume is typically administered by employers themselves, with or without the assistance of professional advisors and service providers. This is the type of plan whose fate dominates debates over pension coverage, funding and regulatory strategies. Of course, the PBA regulates plans, not members, and the great majority of plans do conform to the PBA stereotype, or paradigm. Nonetheless, once it is understood that most workers are enrolled in plans where they have a voice (or the possibility of a voice) in its design and governance, the focus and tone of discussion change considerably. This is particularly true in relation to arguments over the decline of DB pensions and what can be done to arrest it.

Further, much commentary concerning the DB pension system — in both the public and private sectors — rests on the assumption that the cost of these pensions is borne entirely by the sponsor. To the contrary, in some private sector plans, in virtually all public sector plans and in all JSPPs (the latter two groups overlap), active members contribute to their own pension. Those who do so constitute a clear majority of the membership of all plans.

Finally, it is often asserted that sponsors will terminate their DB plans unless they can be assured of particular legislative changes. While any further contraction of the DB system would be very undesirable, and while many changes sought by sponsors may be justified on their merits, most plan sponsors are not free in a legal or practical sense to take such action unilaterally. Sponsors with organized workers — about 80% of all DB members (see Figure 2) — would have to overcome the resistance of the unions that, in many cases, won pension coverage through collective bargaining.

3.2.4 Conclusion

To sum up, Ontario's occupational pension system has been undergoing gradual changes for 20 years or more. In certain respects — such as an increase in absolute numbers of workers covered, the avoidance of a sharp year-over-year drop in coverage rates, the achievement of gender equality in membership, and the introduction of innovative governance structures and plan designs — one might construe these changes as evidence that the system is adaptable and healthy. However, neither internal change nor external developments have so far succeeded in making occupational pensions significantly more attractive to sponsors, or in arresting or reversing the long-term downward trend in overall coverage. The next section seeks to explain why.

3.3 Explaining the Decline in Coverage

Analysts and stakeholders have proposed many different explanations for the decline in pension coverage. Some suggest that changes in labour markets, driven by the changing structure of Ontario's economy, account in large measure for reductions in pension coverage. Others suggest that changes in demography have placed the occupational pensions system under considerable stress. Some contend that excessive or inappropriate regulation encourages employers to defect from the occupational pension system. Others suggest that both workers and employers, for quite different reasons, have developed a less favourable view of DB pension plans in particular. Finally, and most drastically, some analysts contend that DB plans — the dominant form of occupational pension plan — were structurally flawed from the beginning, and that their flaws have simply become more obvious in the years immediately following 2000, during which the system was buffeted by the "perfect storm" of declining long-term interest rates and falling equity prices.

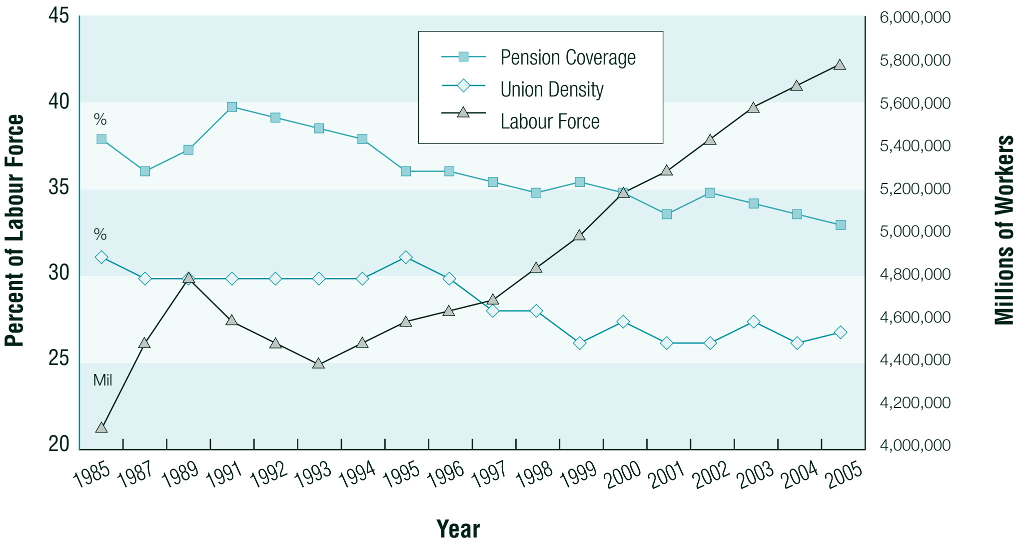
Each of these explanations for the declining coverage of occupational pension plans is reviewed below. So far as possible, each is assessed on the basis of evidence available to the Commission, though it must be said that in regard to some explanations, evidence is in very short supply.

3.3.1 Changes in Ontario's economy and labour markets

Our research, and that of others, suggests that changes in union density — the proportion of workers represented by unions — correlates closely with pension coverage rates. This makes intuitive sense, given the higher rate of pension coverage in unionized workplaces noted in the previous section.

Figure 4 shows that the Ontario labour force grew from 4.1 to 5.8 million workers between 1985 and 2005 (right-hand axis). However, union density and pension plan coverage in Ontario both declined as a percentage of the workforce during the same period, more or less in tandem. Union density decreased from about 31% of the workforce in 1985 to 26.8% in 2005, while pension plan coverage decreased from about 39% to just under 35% (left-hand axis). In fact, neither unions nor pension plans suffered a significant loss of individual members during the period; declining density and coverage resulted from their failure to grow at the same rate as the workforce as a whole.

Figure 4: Ontario Labour Force Growth, Union Density and Pension Plan Coverage



Source: PPIC, CANSIM 279-025 and 282-0078

The Commission's research, and the research literature in general, provide a number of pertinent examples and explanations of how and why union density and pension coverage rates track each other so closely.

To take an obvious example, the public sector is more densely unionized than the private sector and pension coverage in that sector has been relatively stable. By contrast, in the private sector, union density and pension coverage rates have both fallen, more or less in tandem. Another example: between 1987 and 2003, union density dropped significantly in the manufacturing sector and rose slightly in the service sector so that the gap in unionization rates between the two sectors closed considerably. This shift was apparently accompanied by a similar convergence in rates of pension coverage. And another: the proportion of prime-aged women in both union membership and in pension plan membership has increased at pretty much the same rate.

Moreover, changes in union density and in pension rates seem to be closely correlated not only to each other but to employment trends in the manufacturing sector — a bulwark of both unions and DB pensions. Since 1988, Canadian manufacturing employment has seen two major periods of contraction, from 1990–1993 following a cyclical downturn and the advent of the original Canada–U.S. free trade agreement and, after an intervening period of recovery, from 2005 to the present. During this most recent contraction, Ontario alone has lost more than 180,000 — or one in six — manufacturing jobs. The full impact of this contraction has yet to be experienced, let alone documented. However, because it has hit the "big three" auto companies with particular severity, and because they have historically been associated with high rates of unionization and pension coverage, the next few years are likely to see a sharp drop in both.

Ontario has also experienced a similar, though less pronounced, decline in employment in the broader public sector, which accounted for approximately 25% of the provincial workforce in 1991, but only 21% in 2006. Once again, employment in an area of high union density and high pension coverage has been shrinking in relative, though not absolute, terms. And once again, the impact on overall rates of pension coverage has been negative.

Finally, changes in the duration and perquisites of job tenure seem likely to affect pension coverage adversely. Several decades ago, workers may have had one job for their whole working lives and, especially if they were unionized, a reasonable expectation of a pension thereafter. Now, it is not uncommon for workers to change jobs and even careers several times in their working lives and to arrive at retirement with inadequate pensions, one or more deferred pensions from previous employment or none at all. Nor is it uncommon for workers today to hold several part-time, contract, seasonal or temporary jobs at once. Whether or not these workers are unionized — they often are not — employers often decline to provide pensions for them, even though the employer's "core" full-time workforce may enjoy pension coverage. For example, the Commission heard from university sector stakeholders that sessional faculty, who may work at several institutions and are often unionized, nevertheless lack access to pension plans at any of those institutions.

According to one recent study, declining union density, dis-employment in manufacturing and public employment, and new forms of job tenure may together account for as much as 90% of the decline in pension coverage of young men and 75% of prime-aged men during the period 1986–1997. Indeed, according to this study, declining union density alone seems to account for 40% of the decline in pension coverage for men and young women.

Future trends in pension coverage are no easier to predict than trends in the labour market or in the economy as a whole. However, one scenario comes to mind that might lead to increased rates of pension coverage. In sectors of the economy that are already experiencing, or will soon encounter, labour shortages, employers may feel obliged to offer workers inducements to remain in their present jobs. DB pensions might be one such inducement, along with innovative schemes to encourage phased retirement for key workers at the end of their careers. However, this scenario is largely conjectural and seems unlikely to occur in the near term.

3.3.2 Demographic changes

Demographic changes are often cited as contributing considerably to the decline in pension provision. Population aging, in particular, generates great pressure on pension systems in all industrialized welfare states. Indeed, the proportion of Canadians aged 65 or over is expected to double to approximately 25% of the total population within the next 25 years. This will likely pose two challenges for the occupational pension system. On the one hand — subject to the effects of immigration, discussed below — the ratio of active to retired plan members is likely to fall considerably. On the other, as the workforce ages and as longevity increases, more retirees will have to be supported for longer periods of time. While these developments ought to have been foreseeable, studies suggest that some plan sponsors and their actuaries using out-of-date mortality tables may have underestimated the risks they will likely confront in the years ahead. If actuarial underestimates ran as high as 15%, as some U.S. estimates suggest, the costs of funding plans will increase as more modern mortality tables are adopted. This is especially true for mature plans, where the number of retirees is already approaching or outstripping the number of active and deferred members.

Population aging is not the only demographic factor affecting pension coverage. Ontario has the most diverse population in Canada, largely as a result of immigration. According to recent statistics, almost 20% of its population belong to a visible minority group, and members of such groups comprise some 54% of all visible minority Canadians. Moreover, Ontario receives 57% of all immigrants to Canada, and 27% of all Ontario residents are foreign-born, a figure that rises to 44% in the Greater Toronto Area. If occupational pension coverage of members of visible minority groups and recent immigrants lags behind that of Canadian-born workers, as do their earnings in general, their presence in ever-increasing numbers will significantly affect the coverage and effectiveness of Ontario's occupational pension system.

In fact, only one study has so far addressed the issue of pension coverage of immigrants and visible minorities. Its conclusions are unsurprising: immigrants — both male and female — have less pension coverage than Canadian-born workers. However, coverage increases with time spent in Canada, and coverage for male immigrants catches up with that of their Canadian-born co-workers within 10 years. This somewhat positive finding is qualified by three others, which are less so. First, coverage for female immigrants has not been catching up to Canadian-born female workers. Second, pension coverage has remained lower among visible minority immigrant men than among other immigrant men. And third, immigrants who arrive from abroad mid-career — even if they ultimately gain entry to an occupational pension plan — will obviously accumulate fewer years of pensionable service and consequently can expect lower pension benefits on retirement. These findings are of particular significance since immigrants will also likely receive lower benefits from the public pension systems (OAS/GIS and C/QPP) given their shorter residency in Canada, time in the workforce and period of contribution.

If Ontario continues to depend on immigrants to rejuvenate its aging workforce and to sustain its economy, as seems likely, it will ultimately have to address the issue of how its newest citizens will provide for themselves in retirement. And if Ontario continues to pride itself on the ethnic and racial diversity of its population, it will have to deal with the probability that many members of visible minorities who suffer well-documented disadvantages during their working lives will continue to do so after they retire.

Finally, gender is a demographic factor of undoubted significance. As mentioned, women have almost achieved parity with men in terms of pension coverage. However, the same cannot be said for pension adequacy. Parity in coverage is a formidable achievement, largely attributable to the arrival of large numbers of women in the public sector where pensions are widely available. However, the adequacy of pensions for female retirees raises three issues of concern. First, like immigrants who arrive in Ontario mid-career, women who take time out from paid employment for child-rearing and elder care will have fewer years of pensionable service. Second, like immigrants and members of visible minorities who experience discrimination at work, women often earn less than their male counterparts, a fact that diminishes their pensionable earnings. And third, women retirees can be expected to live longer than their male colleagues. If they do, they will likely experience more years during which their pensions will be eroded by inflation. Often beginning as they do with lower pensions, attributable to lower wages and fewer years of service, women are therefore likely to experience greater financial hardship in retirement.

In general, then, demographic factors provide several new insights into implications of the well-documented decline in occupational pension coverage. Increasing longevity will generate increasing pressures on pension costs. As immigrants and members of visible minorities in Ontario's population join the labour force in ever-increasing numbers, pension coverage is likely to fall rather than rise. And coverage *per se* does not tell the whole story of decline in the occupational pension system: the level of pension benefits received by women, members of visible minorities and recent immigrant workers is likely to be lower than that of their white, male, native-born Canadian predecessors and colleagues.

3.3.3 The impact of regulation on pension coverage

Many sponsor representatives argued in their briefs and oral submissions to the Commission that the decline in pension coverage is directly or indirectly attributable to over-regulation.

They cited many significant examples: funding rules that force sponsors to make large, unpredictable and unsustainable contributions to maintain plan solvency without the prospect of swiftly recovering occasional surpluses as an offset; regulatory constraints on innovation in investments, plan design and administration; the need to comply with different regulatory requirements across the country; the imposition of professional standards such as "mark-to-market" accounting rules, which expose pension plans to additional pressures; and the application of trust law doctrines, which impose on sponsors, trustees and service providers tighter restrictions and greater responsibilities than were anticipated when the plans were first established. Added to these examples was a litany of complaints dealing with procedural or structural irritants: unnecessary reporting and procedural requirements; inefficient or unreasonable procedures adopted by the pension regulator; difficulties in dealing with lost beneficiaries and disputing spouses; and the complicating effects of pension plans on corporate financial reporting and restructuring.

The argument comes to this: employers have capped, closed, converted or declined to establish DB plans because the increasing burden of regulation has driven up the cost and trouble of maintaining them. And many more will do so — it is predicted — because regulatory burdens are becoming all the more insupportable in the context of difficult business conditions, an adverse investment climate, and growing costs associated with increasing longevity and other developments.

Given the frequency and force with which this argument was advanced, I take it very seriously indeed. However, the evidence does not seem to support over-regulation as a prime cause of declining pension coverage. The downward trend in coverage — evident in the mid-1970s and well-documented from 1985 onward — predates the introduction of most of the regulatory requirements complained of, and has not accelerated during periods of heightened regulatory or legal change. Moreover, the decline in pension coverage coincides with and is better explained by other factors — principally, the decline in union density and in employment in sectors where DB plans were most prevalent.

But that does not end the matter. On the one hand, legitimate complaints about regulatory laws or practices deserve to be addressed on their merits. On the other, if employers come to believe that the costs of providing pensions are too high, and if some of those costs are associated with the burdens of regulation, it would be prudent to do whatever can be done to ease those burdens. Finally, it is clear that changes in regulation should neither leave plan members without adequate protection nor expose communities to the financial and social costs that flow from plan failure.

This brings me to the argument advanced by those who contend that under-regulation has contributed to the decline in pension coverage. There are two senses in which this might conceivably be true. The first is that more vigorous and proactive oversight of the solvency of pension plans might avoid the need for expensive and, arguably, excessive funding requirements. The second is that past regulatory failures — especially those associated with the insolvency of sponsoring employers — have eroded confidence in the pension system. Better — smarter, more effective and cheaper — regulation might restore confidence and lead to higher coverage rates. However, for the same reasons as I was unconvinced by the argument that over-regulation caused the decline in coverage, I remain unpersuaded by the argument that under-regulation has done so.

Finally, the effects of the *Income Tax Act* (ITA) on pension coverage warrant comment. Initially, this legislation favoured the establishment of DB pensions by allowing sponsors to treat contributions to "registered" pension plans as a business expense, and by allowing workers to defer the payment of tax on this part of their compensation package until they retired and actually drew their pensions. Moreover, workers were permitted to save and shelter more income in a DB pension plan than in a DC plan or an RRSP. However, 1991 amendments to the ITA "leveled the playing field" by providing equal treatment for all three retirement savings vehicles. A study undertaken for the Commission by Jinyan Li concluded that this change in tax policy likely explains the rapid expansion of these alternative approaches to retirement savings. However it is less clear that this expansion occurred at the expense of the DB system, although no doubt some sponsors and some workers — especially younger workers — prefer DC plans and group RRSPs, which typically involve lower contribution levels.

The ITA has also perhaps exerted a drag on pension coverage by too narrowly defining which plans are eligible for registration, and hence for favourable tax treatment. These constraints appear to inhibit innovation in plan design. For example, cash balance plans, which attract extensive enrolment in the United States, cannot be established in Canada because they are not contemplated by the ITA. Or, to take another example, only pension plans whose members are "employees" are eligible for registration. Hence, plans that might recruit members based on some other affinity relationship — say, operators of restaurant or convenience store franchises — are ineligible. Indeed, even self-employed workers who are deemed to be "employees" under provincial labour legislation have been denied eligibility for coverage under the ITA, whose definition of "employee" is more limited. Given recent extensive changes in Canadian labour markets, with fewer and fewer people working under conventional, long-term contracts, these ITA constraints on plan design and membership should be reviewed at the earliest possible moment.

A final effect of the ITA has to do with the funding strategies and investment policies of DB plans. Under the ITA, sponsors are permitted to shelter their annual contributions only to a maximum of 110%, or 120% of plan liabilities (depending on some plan features and circumstances). In consequence, sponsors cannot over-contribute in good times, in order to under-contribute when times are difficult. It is quite possible that these provisions — especially in combination with the legal rules regarding surplus withdrawals — represent a deterrent for employers wishing to initiate or continue plans, and in that respect, they contribute to the decline of DB coverage. However, their more obvious effect is that they hinder the adequate funding of plans already in existence. Similar effects can plausibly be attributed to the federal investment rules, which constrain the scope of investments undertaken by registered pension plans. These concerns are dealt with in subsequent chapters.

3.3.4 Attitudinal shifts

Ontario's occupational pension system ultimately rests, for better or worse, on the voluntarism principle mentioned in Chapter One, and thus on the decision of individual employers to establish or not establish a pension plan. That decision is likely to be influenced by the opinions of many different people: corporate executives such as Chief Financial Officers and Directors of Human Resources; union officials and staff members; professional advisors such as actuaries, accountants and lawyers; and insurance companies, bankers and investment counsellors. The more such people develop hostile attitudes to occupational pensions, the less likely it is that new plans will be established or old ones continued, and *vice versa*. Or to put the matter another way, shifts in the relative influence or power of those who favour or disfavour pensions may tilt the balance for or against them.

Of course attitudes are shaped by new facts, new perceptions of facts and new ways of analysing facts (not always the same thing), and sometimes they are shaped by new values and beliefs, including beliefs about what "relevant others" believe. It is entirely plausible that such shaping influences have indeed caused the attitudinal shifts that observers have detected with regard to occupational pensions. Some examples:

- If surveys of service providers show that most expect DB plans to decline, they are likely to become a self-fulfilling prophecy.
- If younger union members increasingly feel that they are better able to manage their retirement savings than the administrator of their pension plan, the priority accorded pension coverage may alter when union officials sit down to negotiate a new collective agreement.
- If policy makers become convinced that DB pensions inhibit labour market mobility, they are unlikely to support initiatives to promote such pensions.
- If a dominant view emerges among sponsor-side pension professionals that the DB system is in terminal decline, most will "cuddle up to consensus," and few will advise clients to start a new plan for fear of the consequences if their advice turns out to be wrong; in fact, some will advise clients to avoid buying into companies that have such plans.
- If from one perspective, having a pension plan is seen as a valued part of a successful human resources strategy, and from another as preventing optimal deployment of corporate capital, which of these two perspectives prevails will likely depend on whether pension policy is made by the Director of Human Resources or the Chief Financial Officer.

These are not hypothetical "ifs:" they are anecdotes gleaned from my encounters with pension stakeholders and professionals, which reveal increasingly negative attitudes about DB pensions in particular. These attitudes are being expressed not just at public hearings and in publications and speeches, but in union meetings and corporate offices, and in professional and policy-making circles. Cumulatively, they have almost certainly had an adverse effect on coverage.

What, if anything, can be done to change these attitudes?

To the extent that they represent reactions to real defects in the system, the best way to change them is to remedy those defects, and to make it clear that this has been done. To the extent that they are the result of the human tendency to see things in light of one's own interests or through the optic of one's own professional, political or theoretical stance, people with different beliefs, interests and perspectives must be brought together to exchange views concerning possible solutions, or at least to understand that there are many ways of looking at the pension system. And to the extent that they rest on misperceptions or inadequate information, the best way to change such attitudes is to put facts into the public domain. The Commission has attempted to do just that through its public hearings, stakeholder meetings and, especially, its research program.

To sum up, attitudes to occupational pensions will become more favourable and more supportive of increased coverage only if stakeholders and their advisors and advocates are provided with accurate and plausible information and given the opportunity to exchange views, and if ongoing efforts are made to respond to their legitimate concerns.

3.3.5 Inherent structural flaws and "the perfect storm"

A final — and, in some ways, more fundamental — explanation for the decline in coverage rates is that the current DB system was badly designed from its inception. Proponents of this view hold that its architects made erroneous assumptions about the system's infinite sustainability. The key error, if I understand the critique, was undue optimism: the economy would continue to expand indefinitely, ever-rising equity prices and dependably high long-term interest rates would generate the resources needed to keep plans properly funded with relatively low contributions, and post-retirement longevity would remain constant.

The ups and downs of Ontario's economy from the 1970s through the 1990s posed many challenges to pension plans, but also provided periodic opportunities for plans to accumulate large surpluses, and for employers to take contribution holidays and to finance benefit improvements. During this period, moreover, plans came increasingly to depend on equity investments, which produced relatively high returns, albeit with greater risk of periodic reversals. Furthermore, some plans adopted practices and policies that effectively masked the potential for a serious crisis in funding. While these strategies managed for some time to conceal the underlying flaws in the system, by the end of the 1990s the consequences of excessive optimism, the falsity of the underlying assumptions, and the masking effect of ill-considered funding strategies underlying DB plans started to become clear. Two developments, so the argument runs, made them glaringly evident. One was the maturing of many DB plans, with rising numbers of long-living retirees and dwindling numbers of active members. The other was the financial crisis of the early years of the new century when equity prices fell sharply and long-term interest rates declined from highs in the late 1980s to much more modest levels. These developments, of course, occurred against the background of perturbations in the economy and increasing concern for transparency and accountability.

The combination of these and other factors created what is called in the pension community "the perfect storm." In that "perfect storm," numerous plans foundered or feared that they might. As discount rates fell, previously affordable liabilities became much more expensive; sponsors — many of whom had recently taken contribution holidays or granted enhanced benefits — were having to make much higher contributions than they had anticipated, and in some cases, sponsors themselves veered toward insolvency.

Canada and Ontario escaped the worst of the "perfect storm," which caused serious under-funding of pension plans in the United Kingdom and the United States, for three reasons. First, Canadian pension funds were not as heavily invested in equities as funds in some other jurisdictions; second, Canadian equity values increased considerably after 2002; and third, Ontario and other Canadian jurisdictions generally have more robust funding rules, as was pointed out by Colin Pugh in research for the Commission. Nevertheless, an air of crisis developed around the DB system, which — for some informed observers — persists to this day.

On the one hand, this far-ranging and fundamental critique of the DB system is very valuable, as it reminds us that not all problems are amenable to a "quick fix" and that the basic architecture and assumptions of the system may require scrutiny. To a limited extent that scrutiny is initiated in the concluding chapters of this report, but much more theoretical and empirical work remains to be done. On the other hand, the "fundamental flaws plus perfect storm" hypothesis may prove too much. It is tempting (and consistent with recent evidence) to suggest that the DB pension system may well be one of those institutions that is inoperable in theory, but works reasonably well in practice. Whichever is the proper characterization of this hypothesis, however, those who are persuaded of its soundness must surely be tempted to defect from the DB pension system at the first opportunity, if they have not already done so.

3.3.6 Why pension coverage has declined: Some guarded conclusions

The strongest empirical evidence available to the Commission suggests that labour market changes — especially diminished union density and decreasing employment in sectors where DB pensions were historically most common — have caused the largest part of the decline. If they were the only cause, no change I might recommend within the pension system itself would likely do much to improve coverage. However, large, long-term trends seldom have a single cause. The other factors explored in this chapter — demographic developments, regulatory issues, attitudinal change, and a firm view in some quarters that the design of the DB system is inherently flawed — have all likely made some contribution to the decline of the DB system. At the very least, the fact that people believe that they have done so has placed the system under stress. In consequence, however meagre the evidence to support them, none of the factors can be ignored in any attempt to account for the decline.

3.4 Possible Consequences of a Decline in Coverage under Ontario's Occupational Pension System

To recapitulate the themes developed in this chapter and the preceding one, the existing occupational pension system is not perfect. It has never covered more than half of Ontario's workers, now covers only some 34.7% of them, and is at risk of covering an even lower percentage regardless of any improvements that I might recommend to the present system. Further, coverage is spread unevenly between the public and private sectors and, within the latter, among workers in different economic sectors, in enterprises of different sizes, and across class, ethnic and racial (but not gender) lines. Many of the workers who will most need pensions have little or no access to them. And benefit levels for some retirees (notably women and recent immigrants) are lower than for others.

But despite the shortcomings of Ontario's occupational pension system, its decline should provoke great concern. Even in its present state, the pension system continues to ensure that millions of Ontarians will enjoy a decent retirement income, which will reduce or eliminate their reliance on needs-based public pensions, and enable them to buy goods and services from others. Moreover, the current system provides a convenient vehicle to encourage savings by workers who otherwise might be tempted to spend what they earn, and to ensure that their collective savings play an important part in sustaining Ontario's economy and infrastructure.

What consequences will ensue if the decline in pension coverage continues? Some of those consequences were described in Chapter Two. To recapitulate: we can anticipate an increase in the number of older Ontarians living without income from occupational pension plans, declining markets for goods and services purchased by seniors, declining tax revenues and increasing public welfare costs, and a possible decrease in the large sums presently invested by pension funds in Canada's and Ontario's capital markets. Moreover, once overall pension enrolment drops below a certain level, the occupational pension system as a whole will become increasingly difficult to sustain; this is likely to happen sooner rather than later if enrolment in the public and private sectors continues to diverge so considerably.

Since these are all consequences Ontarians wish to avoid, if possible, it follows that public policy should attempt to arrest or reverse the decline as well as disparities in coverage and benefits.

This diagnosis of the decline of DB plans explains much of what follows later in this report by way of prescription. In Chapters Four through Seven, I recommend measures by which sponsors' concerns, as well as the concerns of active and retired members, might be addressed. In Chapters Eight and Nine, I canvass a number of innovations in plan design, funding and governance that should help to arrest the decline in coverage, that may provide more workers with at least the functional equivalent of classic DB pensions, and that will hopefully provide new platforms for expanded coverage. In Chapter Ten, I suggest how government can respond in a more orderly and informed way to the challenges and opportunities that confront the pension system.

I conclude with a paradox: coverage should not be achieved by impairing the security of the pension promise for workers and retirees, but security cannot realistically be purchased if sponsors are required to pay too high a price for it. In short, a delicate balance has to be struck among policy goals that are all desirable but not always easily reconciled.

CHAPTER FOUR – FUNDING

4.1 Introduction

Of all the issues confronting me, none is more crucial — or more complex — than funding. This is obviously true for those most immediately involved with defined benefit (DB) pension plans. Sponsors want to know what it will cost them to keep their pension promises, active members that the plan will be able to provide for them on retirement, and retirees that their monthly pension cheques will continue to arrive. But it is also true for others at one remove from the plan: pension regulators want to avoid plan failures, tax collectors the illicit sheltering of corporate income, union members the loss of much-valued and hard-won benefits, and investors and creditors the unanticipated "legacy" costs of maintaining a pension plan. And at the most general level, everyone concerned with the social and economic health of this province will want to have an accurate idea of how well-funded or otherwise are its occupational pension plans.

However, there seems to be little consensus about how to establish rules that will ensure that plans are "adequately" funded. This is partly because any given set of funding rules will have variable effects that depend on the design and benefit structure of plans; on the demographic profile of their members; and on the different points in the business cycle, the trajectory of the sponsor's business fortunes, and the rise and fall of interest rates and equity prices at which "adequacy" is being tested. But it is also partly because stakeholders differ over what is "adequate" funding, not only among themselves and within each group, but, depending on the issue, from one stage in the life of a plan to the next.

This last observation deserves further consideration. Rules designed to produce greater security for retirees, for example, may drive up the sponsor's costs or require earlier payment of contributions, thus creating resistance toward improving pension benefits, increasing other parts of the compensation package paid to active plan members, or even continuing to operate the plan. Rules designed to make the sponsor's costs more "reasonable" or "realistic" may somewhat impair the security of the plan, but may also make the sponsor's business more viable and, over the long run, improve the prospects of well-paid employment — and good pensions — for its workers. Rules designed to encourage higher levels of funding may encourage sponsors to pursue more aggressive — and riskier — investment strategies, which in the end makes plans less, rather than more, secure.

Nor, as I noted in Chapter Three, are stakeholders alone in experiencing ambivalence. Public policy makers also have difficulty in resolving funding issues. For example, my terms of reference instruct me to both ensure the "viability" of the DB pension system and to propose solutions that are "affordable." To some extent, however, "viability" may involve a modest increase in expenditures — somewhat less "affordability" — both by sponsors to maintain higher levels of funding, and by government to promote better plans and plan governance and to more effectively regulate the system.

I underline this last point. If recommendations in this chapter concerning the reform of funding rules are to have any chance of successful implementation, they must be accompanied by significant investment in the enhancement of the regulatory machinery and by the reform of governance, proposed in Chapters Seven and Eight, respectively.

I make these points not merely to acknowledge how difficult it is to design "scientific" — or even "sensible" — funding rules that will serve everyone's interests all the time, but to explain why I have defined my own ambition in this chapter much more modestly.

I begin with a baseline conviction: that however absolute the pension promise might appear to be, some degree of risk is inevitable in pension funding. From this conviction follow five propositions that inform my analysis and recommendations: (1) that risk assessment should be evidence-driven and not outcome-driven; (2) that in order to be evidence-driven, risk assessment should be as little influenced by wishful thinking as possible; (3) that pertinent assumptions should be made transparent, and relevant information should be disclosed; (4) that risks accepted when taking decisions affecting others should reside within narrower tolerances than risks knowingly assumed by people for themselves; and (5) that for all of these reasons, funding rules should be designed so as to force participants to make hard choices as explicitly, thoughtfully and responsibly as possible.

Bold language, perhaps — but as noted, modest ambitions. The conventional terminology used to talk about risk, the expert methodologies used to assess it, and the range of regulatory measures used to limit or accept it, are all too deeply entrenched for me to change or even challenge them to any great extent. However, where a case is made for change, I propose change in a way that accords so far as possible with the five propositions set out above.

This leads me to a final introductory observation. When change is introduced into a complex system such as the pension system, it must be done in a way that allows the stakeholders and the regulator to adjust to new requirements. New financial arrangements will have to be made, new analytical systems will have to be installed, new reporting and vetting procedures will have to be designed, and new rules and methodologies will have to be assimilated by all participants. I therefore emphasize in Chapter Ten that many — perhaps most — of my recommendations should be accompanied by transitional measures designed to bring them into effect as rapidly as possible, but not so rapidly as to destabilize pension plans, the employment relations they support or the regulatory regime that oversees them.

4.2 Theories of Pension Funding and Pension Policy

Conventional terminology, expert methodologies and regulatory measures are often explained or justified by "theories" of pension funding whose descriptive and prescriptive force is sometimes more evident to their authors than to other people.

Active member and retiree groups often characterize the pension fund as part of their total compensation package, as deferred wages for work already performed, and consequently, as property set aside for — and in that sense "owned by" — the beneficiaries. This theory of what pensions are and who owns the pension fund leads them to question any approach to funding issues that might reduce the accumulation of fund assets or render them unavailable for pension purposes. The most well-known and controversial claim — to those who hold contrary views — is that surplus funds that accumulate in the plan belong unconditionally to the beneficiaries. Some important court decisions and legislative developments that have given beneficiaries' claims on pension funds precedence over those of the sponsor are cited by proponents of this theory as supporting their position.

Employers, on the other hand, begin with the theory that their obligation is no more and no less than to deliver specified benefits to those entitled to them. The purpose of a pension fund is to earmark and accumulate assets sufficient for that purpose. If the assets are insufficient, the employer must make up any deficiency.

However, if the assets grow to a size in excess of requirements, the surplus — on this theory — logically belongs to the sponsor whose contributions have ultimately made growth possible. This explains why sponsors characterize the current funding rules as "asymmetrical:" they are required to cover all risks and fund any deficits, but do not get the unconditional use of the surplus on partial or full wind-up.

In his research paper prepared for the Commission, James Wooten analysed these arguments and found them both less than totally compelling. The deferred wage theory, he notes, does not seem to account for many aspects of the current rules, and most especially does not explain why the sponsor must augment the fund not only when the time arrives to make good on the pension promise but also during the life of the plan. At the same time, he points out that the asymmetry argument fails to address two key facts: that active plan members and retirees bear some of the risks associated with the plan, and that employers whose ongoing plans are in surplus generally have the right to take "contribution holidays." Nor, he notes, is there any clear explanation under either theory of whether individuals whose employment is terminated prior to retirement should receive an amount in lieu of their pension, whether it is based on accruals to date or on future expectations as well. Further, Wooten describes the current surplus-sharing rules as "incoherent" and as creating sequential entitlements: employers may use the surplus in the plan during its lifetime, while employees may have access to it on partial or full wind-up. Finally, Wooten draws attention to U.S. tax rules, which discourage sponsors from claiming any surplus in the plan upon wind-up, and suggests that these rules contributed to the low funding levels at which U.S. plans were maintained, even during the 1990s when plans were achieving high investment returns.

Of course, even those who espouse different theories of pension funding acknowledge that rules adopted in deference to them may — and should — influence plan performance and public policy outcomes. I heard from many that more flexible rules, including greater employer access to surplus, would encourage sponsors to maintain existing plans, enhance them and even, perhaps, create new ones. Such rules, I was told, are more consistent with the realities of funding plans over the long term in inevitably volatile conditions. At the same time, I was told that flexible funding rules are unlikely to make much difference to employers who already have plans, or to those who might consider establishing them in the future. As I indicated in Chapter Three, much empirical evidence indeed suggests that the presence of unions, firm size and general labour market conditions — not funding rules — have been the prime determinants of coverage under our voluntary DB pension system. However, it does not follow that my only objective in reforming the funding rules should be to ratchet up the financial security of existing plans in order to protect active members and retirees. Not only do sponsors make some sensible arguments in support of their legitimate interests; it is of the essence of a voluntary system that those arguments should be acknowledged and interests accommodated, if possible.

A review of these competing "theories" of plan funding, of Wooten's telling critique of them and of their possible implications for the future of the system suggests that while they may have some appeal, they do not lead inevitably, predictably or consistently to any particular set of funding rules. This conclusion makes it necessary for me to reiterate that my own attempt to clarify and recast the pension funding bargain proceeds not so much from a single grand theory of pension funding as from a determination to somehow strike a fair balance among conflicting theories, principles and interests.

I acknowledge, of course, that any attempt to strike a fair balance will affect existing rights, interests and expectations to some degree. However, in my recommendations in this and succeeding chapters, I have tried to do so only to the extent necessary to achieve fairer outcomes for the pension system as a whole.

In general, I have preferred solutions that favour more plan members over those that favour fewer, solutions that enhance long-term system stability over those that produce occasional advantages for one party or the other, and those that make for clarity over those that contribute to ambiguity and uncertainty.

4.3 Measuring Funding

4.3.1 Factors affecting the measurement of funding

Three distinctive features of pension plans make the measurement of plan funding particularly difficult. First, the pension promise must typically be made good over decades. An employee who is, say, 30 in 2008 may retire in 2043 or 2048 and continue to draw his or her pension until 2068 or 2078 — or even longer. And because pension plans enrol new members all the time, the projected life of any plan is constantly being extended to take account of the promise made to its youngest recruits. Second, the factors that define the value of the pension promise — years of service and either a percent of salary (in final or career average plans) or a fixed dollar amount per unit of service (in flat benefit plans) — are not constant. They change because the makeup of the plan population changes, because life expectancy changes, because salaries and promised benefits change, and because business conditions and regulatory requirements change.

Third, the cost of paying for the pension promise is highly volatile. In principle, the plan's assets must suffice over time to meet its evolving long-term liabilities — the future costs of honouring promises made to current employees and retirees. But those assets comprise three elements: annual contributions calculated actuarially every three years, special payments to make good any deficiencies experienced during previous periods, and returns earned on the investment of these contributions and special payments. So long as sensible assumptions have been made, and no unusual events have occurred, the first two of these three elements can be managed reasonably well. It is the third that generally causes the valuation of assets to fluctuate considerably. Pension funds invest in bonds, equities and other types of assets. If bond yields rise, if equity prices fall, if interest rates fluctuate, if the worth of other holdings wobbles, the value of the plan assets may either exceed or fall well short of what is needed to meet the obligations of the plan — or do both within a fairly short time span. Indeed, because the plan must provide departing employees with lump sums or annuities in some circumstances, the same events that cause asset values to fluctuate also affect the value of its liabilities.

4.3.2 The role of expert methodologies in measuring plan funding: actuarial and accounting practices

For all of these reasons, the valuation of pension plan assets and liabilities is a formidable challenge. However, it is a challenge that must be met at least every three years when, as required by Ontario's *Pension Benefits Act* (PBA), the plan administrator files a valuation prepared in a manner "consistent with accepted actuarial practice and with the requirements of the Act and this Regulation." These triennial valuations set the requirements for funding over the next three years, enable the sponsor to calculate its obligations to contribute to the pension fund, and provide the regulator with a benchmark to assess whether adequate contributions have been made. If a valuation discloses that a plan is funded at less than 80% of its liabilities (or less than 90% for larger plans), annual valuations are required until the plan's funded status improves to the relevant threshold.

Funding valuations, as noted, must conform to accepted actuarial practice — in effect, to the professional standards set by the Canadian Institute of Actuaries (CIA). All plans are required to submit to two methods of valuation: "going concern" and "solvency" valuations — but a plan must be funded according to whichever method produces the highest level of funding. If a valuation reveals a deficiency in the plan's funding, that deficiency (along with normal cost contributions) must be paid into the fund ("amortized") over a fixed period of years.

Going concern valuations have been required under Canadian legislation for some time. As the name suggests, such valuations assume that the plan will continue indefinitely and will predict how liabilities and assets are likely to accumulate in the future and thus identify so-called "current service costs" — the contributions required to enable the plan to pay for the liabilities it will predictably encounter over the next three years. In addition, a going concern comparison of the plan's projected performance with its actual performance over the past three-year period can generate either a going concern surplus (an "actuarial gain") if better than expected, or an unfunded liability (an "actuarial loss") if the experience was worse or if new unfunded benefits have been added. Unfunded liabilities or losses must be amortized over 15 years; gains are available to reduce the amount to be paid by way of scheduled contributions (a contribution holiday).

Because going concern valuations focus on the long term, they must inevitably rely on assumptions about how the plan's liabilities and assets will evolve in the future. Although the choice of assumptions has a considerable impact on the level of contributions that will be required from the sponsor, the PBA regulations and the CIA's standards of practice allow more latitude to actuaries conducting going concern valuations than solvency valuations. Nonetheless, going concern assumptions are also generally required to contain a margin of conservatism. This margin is intended to incline plans toward surplus rather than deficit.

Solvency valuations — unlike going concern valuations — assume that the plan will be wound up immediately. This means that solvency valuations rest on a less conjectural foundation. This has both positive and negative aspects. On the one hand, plans need not take account of projected salary and benefit increases in the context of solvency valuations. On the other, assets and liabilities are valued by reference to current rather than conjectural conditions in financial markets, although they may be averaged or smoothed over a short time. This last point is of considerable significance. Under existing pension regulations, solvency valuations proceed on the assumption that annuities must be provided for all retirees and for those eligible to receive a pension "immediately." Plan assets must therefore be sufficient to cover the cost of such annuities under current market conditions. Depending on long-term interest rates, which effectively set the price of annuities and lump sum payments out of a pension plan, this can be an onerous requirement. Further, if a solvency valuation reveals a deficiency in the plan's funding, that deficiency (along with normal contributions) must be amortized over five years, rather than 15 years as with going concern valuations.

Solvency valuations often require plans to be funded at higher levels than they would be under going concern valuations. However, this outcome is by no means inevitable. Solvency valuations came into force in 1992 after a period when many plans were perceived to be under-funded. However, for about a decade thereafter, under very favourable market conditions, most plans were funded to going concern valuations. Then, from about 2000 onward, solvency valuations dominated funding requirements, with plan liabilities being driven upward as the cost of providing annuities and lump sum payments out of a plan increased steadily due to the decline in long-term interest rates.

These shifts over the past three decades have triggered a debate over the funding rules. With no change in its actual circumstances, a plan that was fully funded at one moment might swing into deficit the next (or *vice versa*), depending not only on actual changes in its assets and liabilities but also on the methodology of whichever valuation method happened to predominate in the economic circumstances of the moment. Moreover, a shift in the plan's funded status might, in turn, precipitate a shift in the quantum and rate of payment of sponsor contributions and special payments.

Some stakeholders who were adversely affected by shifts and swings at particular moments in time proposed that their plans be exempt from whichever funding method appeared to be the source of their discomfort — most recently, solvency funding. On the one hand, they argued, solvency funding increases the volatility and overall cost of funding their plans; on the other, solvency funding is premised on the possibility that plans will wind up with insufficient assets, a fate that, for various reasons, is most unlikely to befall certain types of plans. Their concerns are understandable and are addressed elsewhere in this chapter. However, a study undertaken for the Commission by Brian FitzGerald suggests that the current funding rules actually do allow plans to maintain reasonable funding equilibrium over time, unless they encounter the extreme but atypical volatility that characterized the business and financial environment during the "perfect storm" years early in this decade. This seems to suggest that tweaking, rather than transforming, the present funding rules would be the wisest approach.

Finally, in addition to being actuarially valued for regulatory and funding purposes, pension funds are also valued so that their effects on the sponsor's overall financial health can be accounted for. In recent years, internationally accepted accounting standards have adopted "mark to market" principles, which increasingly reflect the logic of solvency valuation. This tendency is likely to ensure that pension plans are treated on the sponsor's balance sheet in ways that emphasize their cost and volatility, and thus to contribute to their growing unpopularity with corporate financial officers and investors.

In summary, estimating the adequacy of plan funding is intrinsically difficult in light of the three broad factors outlined in section 4.3.1. However, that difficulty is compounded by the fact that while actuarial and accounting rules may provide an accurate picture of the financial state of plans at a given moment in time, these rules can neither anticipate nor recapitulate their dynamic character.

4.4 Common Valuation Rules: Transparency and Timing

4.4.1 Introduction

While each plan — indeed each type of plan — presents special problems of valuation, certain aspects of the valuation process are common to all plans. Specifically, all valuations ought to be as transparent as possible, and all plans ought to be valued not only at fixed intervals but also more frequently, if circumstances warrant.

4.4.2 Transparency

The transparency of valuations, funding decisions and other operational matters is essential to any system of pension regulation. It provides regulators with what they need to know to prevent harm to plans or to the system, and to enforce the law if infractions occur. It reminds sponsors that funding decisions must be reasonable and based on sound analysis. It ensures that actuaries will provide analyses capable of standing up to third-party scrutiny. It reminds plan administrators that their decisions may be subjected to critical oversight by plan members as well as regulators. And most of all, it provides active members, retirees and their advisors and advocates with a window on the pension plan, which may be — in a practical, if not a strictly legal, sense — among a family's largest investments.

However, valuations — in the opinion of many — are not at present sufficiently transparent. The issues that raise transparency concerns flow from regulations that:

- allow certain benefits to be provided without requiring them to be funded or included in the plan valuation;
- allow the spreading or smoothing of changes in certain variables in the funding formula;
- fail to require disclosure of some pertinent funding information; and
- rely on actuarial standards and practices that are opaque or imprecise in certain respects.

Each of these concerns warrants discussion.

Excluded benefits

Excluded benefits are mainly related to solvency valuations but have some application to going concern valuations. While all jurisdictions in Canada require both valuations, most do not allow benefit exclusions.

For example, while indexation paid to current retirees must be included, the cost of future indexation — whether on a formulaic basis or *ad hoc* — need not be included in either solvency or going concern valuations. While exclusion can be seen as an inducement to sponsors to provide this form of protection, indexation is generally an expensive benefit, so its exclusion may substantially undervalue the liabilities of a plan.

To take another example, plant closure benefits must normally be funded and included in a valuation. However, they may be excluded if they are provided pursuant to plan-specific arrangements in place prior to 1991. While this exclusion amounts to a form of "grandparenting" for a limited array of plans, it too represents a hidden factor contributing to their actual cost.

Benefit improvements — even expensive improvements related to past service — may be amortized over a period of five or 15 years. This means that although plan members are entitled to the additional benefits as from their inception, no contribution need be made immediately to cover the cost of providing the benefits. Indeed, such benefits may be introduced even though the plan is already less than fully funded. Although these are not benefit exclusions *per se*, they have the same effect for certain kinds of plans. In particular, a flat benefit or career average plan can avoid including anticipated benefit increases based on increasing salaries, whereas a final average earnings plan cannot.

Smoothing

Ontario regulations allow limited "smoothing" of asset values and discount rates in solvency valuations — that is, they allow a deferred recognition of gains and losses on investments, and a discount rate averaged over a period of time. CIA standards, applicable across Canada, allow smoothing on elements of the going concern valuation. However, the degree of smoothing allowed for solvency valuations in Ontario is greater than in other provinces. The 15-year amortization period of going concern unfunded liabilities is also arguably a form of smoothing, as is the five-year amortization period for solvency deficiencies.

There are good reasons for smoothing. It acknowledges the long-term nature of the obligation and avoids contributions being subjected to sudden and extreme changes. However, smoothing methodologies for going concern valuations are not carefully defined by actuarial practice, and the potential exists for changes in smoothing to be used not to respond to altered circumstances, but opportunistically to hide a funding problem. More importantly, smoothing can detract from clear understanding of a plan's funded position if it is not fully explained in the valuation report.

Funding information

Valuations should be transparent not only to the sponsor, the plan administrator and the CIA's professional standard-setting and discipline bodies, but also to the regulator and to active plan members and retirees. One important matter not presently provided in an actuarial valuation is whether a contribution holiday — a reduction or suspension of normal cost payments — is being factored into the contribution schedule. The rules currently require a valuation to identify surplus in a plan, which would permit it to take a contribution holiday; however, the rules do not require disclosure of whether that holiday has actually been factored into the proposed three-year schedule of contributions. Quite apart from whether or when contribution holidays are appropriate, the fact that they are going to be taken should be transparent. Information about contribution holidays is essential for an understanding of plan funding, both for the regulator and for all plan participants, and should be provided in a document that is fully accessible to them.

Actuarial standards and practice

Many reports and calculations under the Act and regulations must be prepared by a Fellow of the CIA (a self-regulating, professional body) and in accordance with its standards and with accepted actuarial practice. This requirement makes the CIA and its members in effect part of the apparatus of pension regulation. Of course, the extent of their role depends largely on their willingness and ability to anticipate, respond to and reinforce changing regulatory strategies — greater transparency not least among them — and on the willingness of the regulator to pre-empt, defer to or supplement professional norms.

Happily, the CIA has recently changed its standards to improve the transparency of actuarial valuations. For example, all material assumptions must now be explained in a valuation. And it is likely that the new CIA standards will also require each assumption to be "independently reasonable," rather than collectively producing a reasonable outcome, as at present. These two developments together would greatly enhance the transparency of valuations, and it would be helpful if the CIA were to promptly adopt the second as well as the first. However, if it is unable to do so, the government retains the power to require it by regulation.

The question of actuarial discretion is another area that affects the transparency of valuations, especially in connection with going concern valuations. Key issues include the selection of appropriate discount rates and mortality tables. In effect, how the actuary exercises professional discretion with regard to these matters determines the range of choice available to the sponsor in determining how much to contribute to maintain the plan's funding. This situation exposes actuaries to subtle — even overt — pressures to exercise their discretion in a way that produces outcomes agreeable to the sponsor. In the end, of course, the sponsor makes the choice — but it is actuarial discretion that confers legitimacy on that choice.

Whether — and if so, by what means and to what extent — actuarial discretion should be narrowed or structured is a matter of controversy. While narrowing or eliminating discretion would contribute to greater transparency in valuations (and incidentally, insulate the actuary from sponsor pressures), it would also prevent the actuary from capturing the individual characteristics of different plans.

A recent United Kingdom attempt to reduce or eliminate actuarial discretion is generally thought to have had perverse consequences, and that country has recently moved to restore actuarial discretion to something approaching its former scope — and perhaps even to widen it. The Commission's research and a report recently published by the Financial Services Commission of Ontario (FSCO) both suggest that the actuarial profession in Canada is itself addressing the issue. Discount rates used in going concern valuations are gradually becoming more conservative and the CIA has indicated that it will be identifying the permissible maximum rates for going concern valuations. In addition, mortality tables have been updated substantially over the last few years for virtually all plans, making valuations more accurate. Indeed, a small number of large plans now use plan-specific, customized or modified mortality tables, which should improve the accuracy of valuations so long as CIA standards are flexible enough to permit this approach.

Flexibility, of course, does not imply a complete absence of concern, structure or monitoring. On the contrary, as noted, the CIA in recent years has itself been increasingly sensitive to the need to ensure transparency and to tighten up areas of professional practice that might give rise to inappropriate valuations. This approach, supplemented by constructive engagement with the regulator, stakeholders and other professionals, should continue to produce positive results. If not, the adoption of formal rules or regulations by or under the authority of the PBA remains an option.

> **Recommendation 4-1** — The Superintendent should work with the Canadian Institute of Actuaries to ensure that actuarial standards and practices continue to evolve in the direction of greater transparency and more structured discretion. For example, actuarial valuations should reveal the reasons behind the assumptions used in valuations to set discount rates and to select the mortality trends used to calculate plan liabilities. They should also reveal whether the sponsor intends to take a contribution holiday.

> **Recommendation 4-2** — The Superintendent should have the power to require that plans cease using assumptions that are unreasonable or that depart materially from accepted actuarial practice, and to order an independent valuation or peer review of a report, at the expense of the plan, if there are grounds to believe that the actuarial valuation misrepresents a material factor in its funding.

The changes in valuation rules, outlined above, will undoubtedly improve transparency — a good in itself; and some may also enhance the reliability of actuarial valuations, the autonomy of actuaries, the security of plans and the efficacy of regulation. But there is no denying that the cumulative effect of valuing all benefits, disallowing smoothing, structuring actuarial discretion and ordering additional valuations could mean a substantial shift in the timing of contributions or, indeed, an increase in the overall level of contributions required from sponsors. Since some of these practices are widespread and some less so, they will have varying effects on plan sponsors. Nonetheless, it seems quite likely that the measures I propose will exacerbate the volatility of funding for some sponsors, and lead many to resist even more strongly the introduction of new or enhanced benefits, including indexation. In the latter event, I suspect that many active member and retiree representatives will align themselves with sponsors, since they would rather have a contingent promise of larger benefits in the future than a greater certainty of receiving the lower benefits presently agreed.

For these reasons, so far as possible, the adverse consequences of increased cost and volatility should be avoided, minimized or offset. How can this be achieved? One possibility is that sponsors might be given an extended amortization period over which to fund the higher contributions expected of them. Another is that a methodology might be developed so that well-funded plans might be relieved of certain obligations to which under-funded plans are made subject. A third is that access to new or additional benefits may remain contingent until they are either fully funded or reduced, so that they are paid only to the extent to which they are funded. These and other solutions to the problem of increased cost and volatility obviously involve risks as well, especially the risk that the sponsor may encounter financial difficulties during the extended amortization period. However, in my judgment, the risks associated with longer amortization periods are lower than those generated by current rules and practices that discourage transparency and impair clear-minded decision-making. On balance, then, I favour enhancing transparency and acknowledging a degree of risk-taking because, as I confessed earlier, I believe that funding rules should be designed so as to force participants to make hard choices as explicitly, thoughtfully and responsibly as possible. Valuation and funding rules that tend to obscure relevant information should be minimized.

> **Recommendation 4-3** — Going concern valuations should no longer permit the exclusion of promised indexation benefits. Solvency valuations should no longer permit the use of smoothing practices or the exclusion of benefits. A special exception should be made for those plans that continue to provide plant closure benefits pursuant to a specific, long-standing commitment to continue their non-funded status.
>
> Potential increases in sponsor contributions attributable to these enhanced transparency measures should be offset so far as possible by the extension of amortization periods, by selective relief from contribution increases for well-funded plans or by other means.

4.4.3 The timing of valuations and reporting

The current reporting rules require full actuarial valuations to be performed for each plan every three years on both a solvency and going concern basis. An additional nine months is allowed for the actual filing of the valuation, with further delays permitted if the regulator consents. Annual valuations are required for plans that have fallen below a certain level of funding, as set out in the regulations. All plans are also required to file annual financial statements, which contain a considerable amount of detail and provide some insight into their current level of funding.

It was put to me that the triennial norm — especially when extended due to statutory and discretionary delays in filing — allows too much time for a plan to shift from surplus to deficit, or to go from a modest deficit into steep decline. There is some suggestion, for example, that during the "perfect storm" of the early years of this decade, some plans took contribution holidays based on their last filed valuation despite an intervening sharp decline in their funded status. To prevent such inappropriate actions, and to bring developing problems into timely focus, many submissions to the Commission proposed that reporting should occur more frequently. While most European countries and Canadian jurisdictions require triennial valuations, the United Kingdom and Quebec require annual "mini-valuations," in addition; the United States requires full valuations every year.

However, full annual valuations on the U.S. model represent a significant additional cost to sponsors, plans and, by extension, other stakeholders. Mini-valuations seem like a promising alternative, but since they are likely to present a partial, distorted or unclear picture of the plan's finances, they may metamorphose into full valuations. (Perhaps for this reason, Quebec has yet to implement its mini-valuation requirements.)

An alternative approach is to require more frequent filings by plans that are — or are likely to be — in difficulty. Annual valuations are already required for Ontario plans whose triennial valuation indicates that they are funded below a threshold defined in the regulations. What is needed is a strategy for identifying plans whose funding deteriorates between triennial filings to the point at which the plan is at risk. The Office of the Superintendent of Financial Institutions (OSFI), the federal pension regulator, several other Canadian regulators and their U.K. counterpart all monitor plans more proactively than does Ontario: if they find cause for concern, they request interim valuations.

This approach has the merit of placing the extra burden of more frequent reporting on a limited group of suspect plans rather than on all plans. Since the value of an actuarial valuation declines as time passes, it has the additional virtue of providing the regulator with information that is as up-to-date as possible. However, the success of this approach depends upon the regulator having the capacity to identify economic conditions and other factors that may give rise to problems across the pension system, to develop plan-specific benchmarks and to monitor plans more closely when they begin to appear on its "radar screen." The need for greatly expanded capacity in Ontario's regulator is dealt with at greater length in Chapter Seven.

> **Recommendation 4-4** — The current requirement for an actuarial valuation every three years should be maintained. The time for filing the valuation after it is due should be reduced from nine to six months. Extensions should be given only in exceptional circumstances.
>
> **Recommendation 4-5** — Plans whose triennial valuation shows that their funding has fallen below a threshold to be specified by regulation should continue to be required to perform and file an annual valuation.
>
> **Recommendation 4-6** — The Superintendent should develop the capacity to monitor the pension system, and individual plans, more closely, and should have the power to order an interim valuation at any time if there are reasonable grounds to believe that a particular plan is at risk of failure.

Finally, it is important that plan sponsors and administrators and their professional advisors understand that promptness and accuracy in filing valuations and other reports are essential. While these standards are no doubt met in most cases, the inability of the regulator to deploy adequately trained staff to closely monitor filings may mean that some transgressions are going undetected. It is certainly not optimal that valuations and other reports submitted by plan administrators should, for the most part, be read superficially (or not at all) long after their submission. At the very least, those who file late or inaccurate documents should know that they stand a reasonable chance of being detected and sanctioned. The same approach should be taken with other participants whose tardiness or non-compliance with prescribed filing requirements delays timely reporting. I have in mind, for example, employers with multi-employer pension plans (MEPPs) who fail to provide the plan with a list of employees and the contributions made on their behalf. While the Superintendent and his staff are already armed with the necessary powers, and use them to some extent, I am recommending heightened vigilance to achieve higher and faster rates of compliance.

> **Recommendation 4-7** — The Superintendent should more aggressively discourage and more predictably sanction late filings, and develop a capacity to scrutinize filings to the extent necessary to improve the likelihood that inaccuracies will be detected.

4.5 One Size Does Not Fit All: Ensuring That Funding Rules Are Appropriate to Each Plan Design

The existing funding rules treat single-employer defined benefit plans as paradigmatic — as the plan model from which limited exceptions and departures have been permitted. This approach is problematic for at least two reasons.

First, while DB single-employer pension plans (SEPPs) number in the thousands and represent the most ubiquitous type of plan design by far, SEPPs cover only 31% of all workers enrolled in DB plans (and 41% of workers with any kind of pension coverage). In terms of membership, if not numbers of plans, MEPPs and/or jointly sponsored pension plans (JSPPs) clearly dominate Ontario's DB pension system. Second, as Table 1 demonstrates, MEPPS and JSPPs display different institutional characteristics from SEPPs, including their arrangements for sponsorship, governance, contributions, benefits; their strategy for dealing with risks and Pension Benefits Guarantee Fund (PBGF) "insurance" coverage; their union involvement in establishing the plan; and, to a lesser extent, their location in either the public or the private sector.

TABLE 1: DESIGN CHARACTERISTICS OF DEFINED BENEFIT AND SIMILAR PLANS

PLAN DESIGN	JSPP	MEPP	SEPP
Percentage of workers enrolled	**35%**	**34%**	**31%**
Sponsorship	Joint with members (multi- or single employer)	Multi-employer sponsor or joint with members	Single employer
Governance	Joint	Members only or joint with sponsors	Sponsor only or some member involvement (rare)
Contributions	Contributory	Sponsor only or contributory	Sponsor only or contributory
Benefits	Fixed but reduced on wind-up if under funded	Target: adjust to available funding	Fixed
Risk distribution	Shared	Members	Sponsor or shared
PBGF coverage	No	No	Yes
Union involvement	All existing plans	Usual	One-third based on collective bargaining agreement
Sectoral location	Public or private (none presently private)	Public or private	Public or private

The question is whether these differences in design necessitate or justify differences in funding rules. A brief review of each design element suggests that this is indeed the case.

Sponsorship

A SEPP is sponsored by a single employer; the chances of that employer getting into financial difficulty to the prejudice of the plan are much greater than in the case of a MEPP (or most JSPPs), where multiple employers are available to sustain the plan, even if one goes under. Many MEPPs and most JSPPs are more able to spread risks and amortize costs over a larger member base than almost all SEPPs. Funding rules should therefore be designed to take account of the different risks inherent in each plan type.

Governance

SEPPs are almost always governed and administered by the sponsor acting unilaterally, although in principle nothing prevents a SEPP sponsor from agreeing to the participation of active and retiree members in governance procedures. If one of the purposes of the funding rules is to ensure that the interests of beneficiaries are properly safeguarded, that purpose becomes easier to achieve when the beneficiaries themselves have a significant voice in decision-making that affects them, as they do in the case of MEPPs and JSPPs. Of course, it becomes especially important that governance in these plans meets high standards.

Contributions

By definition, SEPPs depend on sponsor contributions. So do JSPPs, but their active members share responsibility with the sponsor for maintaining a level of contributions sufficient to keep the fund solvent. MEPP sponsors, however, cannot be required to increase their contributions for the duration of the collective agreement by which they are fixed, even if the fund is in deficiency. Consequently, for MEPPs, and to a lesser extent JSPPs, contributions effectively determine benefits; the opposite is true for SEPPs. Funding rules might sensibly respond to this important distinction.

Benefits

In DB SEPPs, benefits are by definition “defined” or fixed. Moreover, once accrued, they cannot be reduced. As noted, the obligation to provide these benefits defines the amount the sponsor must provide to keep the plan solvent. If the plan has insufficient assets to make good the pension promise, the sponsor must make good any deficiency by way of special payments amortized over a number of years. In MEPPs, however, the plan is committed only to providing a target benefit. If the target cannot be achieved with the available funds, benefits may be reduced (including accrued benefits and pensions already in pay). JSPPs are somewhere between the two: accrued benefits are normally regarded as fixed, but can be reduced if, upon being wound up, the plan turns out to be under-funded. In practice, moreover, their joint governance structure allows JSPPs to continually rebalance contributions and benefits, as required, by the plan’s funded status, and to deliver benefits on a contingent basis in the sense that their provision or magnitude depends on the availability of funding. A strong case can be made for having different funding rules for plans with defined benefits and those with target or contingent benefits.

Risk distribution

SEPP sponsors claim that they bear the risks associated with plan funding. This claim is challenged by plan members who argue that in various ways, they too assume risks — especially those associated with under-funding and plan failure. Without purporting to resolve this conflict, it is at least clear that the SEPP situation differs from that which prevails in JSPPs where, by definition, risks are shared between the members and the sponsor, or in MEPPs, where they rest wholly on the members.

PBGF "insurance" coverage

SEPPs are obliged to pay annual premiums to the province's PBGF, which guarantees payment of the promised benefits up to a maximum of $1,000 per month in the event that the plan is wound up with insufficient assets. MEPPs and JSPPs do not pay such premiums and their members are ineligible for coverage. Arguably, plans that partially "insure" their members might be treated less stringently than those that do not. On the other hand, plans that threaten to offload their losses to others in the "insurance" pool should be regulated more stringently than those that bear such losses themselves.

Union involvement

Most MEPP and JSPP members — but only one in three SEPP members — are enrolled in plans that originate in an agreement between their employer and a union or other representative body. If the purpose of funding rules is in part to ensure that the "pension bargain" is honoured, and if a representative organization can pressure or persuade the sponsor to reconfigure, reinforce or reinterpret that bargain so as to better protect the interests of its members, it may be reasonable to place somewhat less reliance on the regulatory regime in such circumstances. By contrast, where members lack effective representation, there is a particular need to subject the plan to rigorous regulatory oversight.

Sectoral location

SEPPs are characteristically (but not exclusively) located in the private sector, as are some MEPPs and, potentially, JSPPs. Private sector SEPPs are therefore especially vulnerable to fluctuations in the sponsor's fortunes and to the risk of the sponsor becoming insolvent. They are also more likely to face restructuring as corporate sponsors reconfigure themselves, merge with other corporations or simply decide to redesign or close their plans. Public sector plans — largely MEPPs and JSPPs — have faced divestments or reorganizations as well, but with somewhat less frequency.

The logic of "solvency funding" is that if a plan confronts immediate wind-up, its assets must be adequate to provide all members — active and retired — with lump sum payments or annuities, which will generate the equivalent of the pension they were promised. As I was frequently reminded by representatives from both SEPPs and MEPPs in the broader public sector, these plans are extremely unlikely to confront immediate wind-up, their sponsors will never become insolvent, and they should not be subject to funding rules that treat them as if they were exposed to private sector-type risks. On the other hand, several briefs to the Commission urged that funding rules should treat public sector plans on the same basis as their private sector counterparts.

I acknowledge, of course, that applying a standard set of funding rules to all plans might, on its face, seem more fair, more consistent with the rule of law and more efficient for the regulator to administer. I acknowledge, as well, that previous attempts to provide different plan types with special funding rules have sometimes produced highly unsatisfactory outcomes. The "too big to fail" regulation of 1992, for example, sheltered several major Ontario plans from the requirements of solvency funding; all but two have since teetered on the brink of failure. However, while mindful of arguments to the contrary, the extended analysis of how factors in plan design might influence funding rules is ultimately persuasive. The "one size does not fit all" principle can and should be applied to the design of funding rules — nor would such an approach introduce an anomaly into Canadian pension law. All Canadian jurisdictions presently provide different funding rules for SEPPs, MEPPs and/or public sector plans, and many have different rules for subcategories of MEPPs and for other special types of plans.

> **Recommendation 4-8** — MEPPs, JSPPs and SEPPs should have separate funding rules related to their distinctive characteristics. In general, MEPPs and JSPPs should be allowed more flexibility in funding, while SEPPs should be subject to stricter rules than other plans.

4.6 Multi-employer Pension Plans

MEPP representatives argued strongly that they should be subject only to going concern — not solvency — funding. The going concern approach, they contend, is more appropriate to the resilient, long-term character of their plans. Alberta and Ontario have recently excused MEPPs from meeting solvency funding requirements — in the latter case, only for so-called Specified Ontario Multi-employer Pension Plans, or SOMEPPs, which meet strict conditions, and only for the three-year period 2007 to 2010.

The argument for continuing these arrangements in Ontario in some form past 2010 is compelling, though not without its problems. As noted in section 4.5 above:

- MEPP sponsor contributions are usually fixed through collective bargaining rather than actuarially;
- because they are sponsored by a number of enterprises, MEPPs are relatively immune to sponsor failure unless, improbably, many sponsors fail at the same time, or the dominant sponsor fails;
- MEPPs can adjust benefits to accommodate changing economic assumptions and cope with a shortfall in funds, whether the plan is ongoing or being wound up; and
- MEPP active members (but not usually retirees) are influential and often control plan decision-making as a result of a statutory requirement that not less than 50% of a MEPP governing body must represent plan members.

All of these considerations argue for allowing MEPPs to subject themselves to the less rigorous discipline of going concern — rather than solvency — funding, if they wish to do so.

However, the case for exempting MEPPs from solvency funding is not without its difficulties. For one thing, going concern valuations as presently conducted allow for a significant range of discretionary decisions and, to some extent, may lack transparency. For another, they contemplate much longer amortization periods (15 years) than solvency valuations (five years) and thus permit plans to remain under-funded for a longer time than seems prudent. This could be problematic if there is a cyclical downturn in the MEPP's sector or in financial markets. The SOMEPP regulation addresses this issue sensibly by requiring MEPPs to amortize fund deficiencies over 12 rather than 15 years, and by requiring benefit improvements that push the funded status of a plan below certain levels to be funded over eight years. Thirdly, the absence of a solvency valuation — whatever its defects — deprives trustees and administrators of important perspectives on the financial health of the plan. All of these issues were dealt with by the 2007 SOMEPP regulation.

A second set of concerns derives from the distinguishing feature of MEPPs: they address the issue of "full funding" rather differently than SEPPs. While surpluses for MEPPs may be used to fund contribution holidays or benefit improvements (as with SEPPs), unfunded liabilities in MEPPs are usually dealt with by reducing accrued or future benefits, including pensions already in pay — an option generally unavailable to SEPPs. Of course, if MEPP sponsors and their unions agree, benefit reduction can be avoided by renegotiating the sponsor contributions that are fixed in their current collective agreement; and in MEPPs that provide for member contributions, those contributions may be increased as well. But as a practical matter, these alternatives are often difficult to implement.

Consequently, benefit reduction is a real and present danger for most MEPPs and their members. Who will feel the greatest pain of benefit reduction is obviously a controversial issue, especially if it is not shared on a *pro rata* basis among retired, active and future plan members. Given that retirees have no voice in plan governance in many MEPPs, there is at least a possibility that their interests will not be protected. Moreover, since MEPPs are not "insured" by the province's PBGF and do not wish to be, in those relatively rare cases where a MEPP actually does fail, beneficiaries cannot look to the PBGF for compensation. And finally, many MEPP members are apparently unaware that their pension benefits are not defined or fixed but are, instead, target benefits to be achieved, if possible, and reduced, if not. This is a serious shortcoming that could portend internal difficulties in the MEPP community, given that a number of MEPPs are currently funded at well below 100% of liabilities on a going concern basis.

These issues are addressed in greater detail in Chapter Six, which deals with plan failure, and in Chapter Eight, which deals with plan governance. However, to make a general point: if MEPPs are to be given a standing exemption from solvency funding, as they request and I propose below, they must be willing to do two things. First, they must acknowledge that they are accepting greater risks by abandoning solvency funding and ensure that their members are well aware of this fact. Second, they must initiate reforms in their governance arrangements that will ensure greater transparency in risk management, greater accountability by plan administrators, and greater influence by beneficiaries over decisions being made on their behalf in this new, riskier atmosphere.

Several issues of implementation must also be addressed. For example, the SOMEPP regulation provides relief from solvency funding only to MEPPs with more than 15 participating sponsors and, in other respects, attempts to ensure that only truly diversified MEPPs gain the benefit. While the details are negotiable, the basic concept is surely right: the obligation to provide solvency funding should be relaxed only for MEPPs whose design and other institutional features justify such relaxation. In the absence of solvency funding, and given the target nature of the benefits and fluctuations in asset values, it is difficult to determine the value of an active MEPP member's future pension. All of these problems are capable of being resolved, but they require detailed consultations between MEPP representatives and those responsible for drafting legislation to implement this report, assuming its recommendations are accepted.

In general, the 2007 SOMEPP regulation provides a realistic basis for designing a more complete and permanent exemption of MEPPs from solvency funding. It has the added advantage of providing at least a brief window on how such an exemption might actually work, the difficulties that have to be resolved, and the positive possibilities for the growth of MEPPs that might ensue. The latter, as I explain in Chapter Nine, should be embraced as an important goal of Ontario's pension policy.

> **Recommendation 4-9** — Following consultation with Ontario's multi-employer pension plans, special legislation and regulations should be developed relating to all aspects of their funding, regulation and governance. The basis for such legislation and regulations should be the Specified Ontario Multi-employer Pension Plan regulation of 2007. After five years, the practical effects of these arrangements should be assessed.

> **Recommendation 4-10** — Multi-employer pension plans should be required to fund only according to going concern valuations, but should continue to provide solvency valuations for the information of the regulator as well as their active and retired members.

4.7 Jointly Sponsored Pension Plans

As the analysis in section 4.5 suggests, JSPPs resemble MEPPs in many respects. Indeed, there is a considerable overlap between the two plan types in that all but one of the five JSPPs formed so far are MEPPs, and many MEPPs are also jointly sponsored and jointly governed. However, for regulatory purposes, the two are distinguished by several differences in the funding rules under which they presently operate. First, whereas JSPPs must be funded jointly by the sponsor and active plan members, MEPPs need not be funded in this fashion and are, indeed, often funded solely through sponsor contributions. Second, whereas MEPPs may reduce accrued benefits to meet funding deficiencies at any time, JSPPs may do so only upon being wound up. Third, whereas MEPPs are presently relieved from solvency funding if they qualify as SOMEPPs; JSPPs are not.

JSPPs, however, wish also to be relieved of solvency funding requirements. To be funded on both a going concern and a solvency basis provides a plan with a margin of safety. Consequently, to be funded only on a going concern basis in the present funding environment implies that the plan is willing and able to assume an additional element of risk. MEPPs are clearly well-positioned in this regard because they have a unique power to deal with a funding shortfall by reducing accrued benefits. The question is whether JSPPs have a comparable capacity to respond to the risk of under-funding. Clearly, they are able to increase contributions to make up funding deficiencies, and indeed have an enhanced ability to do so because they are jointly funded and jointly administered. Experience with JSPPs to date shows that this is more than a hypothetical response. Furthermore, their governance structure also allows them to establish benefits, such as indexation and early retirement on a contingent basis — to provide them if funding is available, and not to do so if the plan's funded status does not permit.

But most importantly, the acceptance of risk is a foundation principle of JSPPs. If, on wind-up, they are unable to fully meet their obligations, they may reduce accrued benefits, including pensions in pay. Moreover, in such a situation their members have no recourse to the Pension Benefits Guarantee Fund. In these last two crucial respects they precisely resemble MEPPs and are very different from SEPPs.

On balance, then, I conclude that MEPPs and JSPPs share sufficient common characteristics that they ought to be treated alike for funding purposes.

> **Recommendation 4-11** — Jointly sponsored pension plans should be required to fund only according to going concern valuations on the same basis as Specified Ontario Multi-employer Pension Plans, but should continue to provide solvency valuations for the information of the regulator as well as their active and retired members. The comprehensive legislation and regulations governing the funding of multi-employer pension plans, to be developed pursuant to Recommendation 4-9, should apply, perhaps with appropriate modifications, to jointly sponsored pension plans.

4.8 Public Sector and Broader Public Sector Plans

Pension plans in the public sector are presently subject to both going concern and solvency valuations, just as if they were private sector plans. However, as a practical matter, going concern valuation, rather than solvency valuation, has tended to drive the funding requirements of many of these plans. In general, both public sector sponsors and unions representing their workers would prefer that this situation — which now depends on particular factors that influence individual plan valuations — be made a permanent feature of the funding rules as they apply in this sector. If all public sector plans were relieved of solvency funding, they contend, public sector sponsors and active plan members would generally be able to contribute at lower rates because the volatility of valuations associated with solvency funding would be reduced. This might be an attractive outcome for the plan participants — but on what basis might it be justified?

The ultimate rationale of proposals to relieve public sector plans from solvency funding is that they are unlikely to be wound up "tomorrow" — the central premise of solvency valuation. Moreover, proponents contend, even if these plans were to wind up, whether "tomorrow" or in the more distant future, there is no practical likelihood that their sponsors would be unwilling or unable to make good any funding deficiencies.

While somewhat overstated, this rationale for relieving public sector plans from solvency funding obviously has some grounding in reality. On the other hand, the long-term prospects of public sector pension plans are not necessarily enhanced by allowing a perception to develop that they provide better or less costly pensions than private sector DB plans, or that the government might subject itself to less onerous funding rules than private sector employers, or that the ultimate safeguard for public sector retirees is the virtual certainty that the taxpayers of Ontario will stand behind their pension plan.

More to the point, there are much better arguments in favour of relieving some public sector plans from solvency funding than the fact that they are "public." Many of them are already MEPPs or JSPPs. Those that are not could (and for other reasons, likely should) join with other SEPPs to become MEPPs. Or if they wish to retain their individual autonomy, public sector plans could become JSPPs or JGTBPPs — a new type of plan described in the next section of this chapter. In any case, whether as MEPPs, JSPPs or JGTBPPs, they will at least be claiming relief from solvency funding on the same grounds as their private sector counterparts. These same approaches, I should note, are open to plans in the broader public sector seeking relief from solvency funding, of which universities may be the leading example.

4.9 Jointly Governed Target Benefit Pension Plans

In Chapter Eight I recommend the introduction of a new type of plan — the jointly governed target benefit pension plan (JGTBPP) — with the following characteristics: it originates in a collective bargaining relationship; it provides for significant participation in governance by both active members and retirees; and it offers "target" benefits. My reasons for stipulating the first two characteristics can be found in Chapter Eight, and for the third, in my discussion of MEPPs and JSPPs above.

To recapitulate: pensions involve a certain element of risk; if people who are making decisions on their own behalf accept risk knowingly, and if they have at their disposal the means of mitigating risk or dealing with its consequences, they ought to be allowed some latitude to establish the kind of pension plan they prefer. I hasten to add that the acceptance of risk ought to be permitted only within fixed limits; that acceptance of risk by plan members ought to be informed and authentic; and that responses to risk ought to be limited to the spectrum of options — reduction of benefits, whether accrued or going forward, while the plan is ongoing or on wind-up, and contribution increases — that are already employed by either MEPPs and JSPPs or both.

I introduce JGTBPPs in the context of this discussion on funding in order to clarify that these proposed new plans will resemble MEPPs in that they will offer target benefits, and will resemble JSPPs in the sense that they will be jointly governed with enhanced capacity to adjust benefits and contributions. Accordingly, they should be funded in a similar fashion to MEPPs and JSPPs. They should also be subject to the same constraints as MEPPs and JSPPs, including restrictions on promising unfunded benefits and accelerated amortization requirements for plans that fall seriously short of being able to pay for the target benefits they have promised.

> **Recommendation 4-12** — Jointly governed target benefit pension plans that are based on an agreement between one or more sponsors and one or more unions, that have established explicit arrangements for joint governance, and that permit accrued benefit reduction in an ongoing plan in order to deal with funding deficiencies, should be funded in a manner similar to jointly sponsored pension plans, as provided in Recommendation 4-11.

In Chapter Five I deal with regulatory controls on transactions by which plans convert from DB to defined contribution (DC) plans. However, I regard conversion of broader public sector SEPPs to MEPP or JGTBPP status as being of an evolutionary character, rather than as a sharp break with the past. Accordingly, I favour a simplified conversion process in these situations, driven largely by a concern for transparency and democratic decision-making, but making clear that target benefits would apply only on a going-forward basis. For similar reasons, but without the complication of changing from defined to target benefits, conversion of broader public sector SEPPs to JSPPs should be made relatively quick and easy.

4.10 Single Employer Pension Plans

4.10.1 Introduction

Though they enrol less than one-third of all DB plan members, SEPPs require more extensive analysis, receive more intensive oversight and are required to meet different funding expectations than other types of plans. Plausible reasons might explain this: few have governance structures that provide internal checks and balances to the sponsor's unilateral administration of the plan; some are quite small and unable to develop, implement or afford sophisticated strategies for investment, member services and other functions; none can adjust accrued benefits to meet funding shortfalls; and all — even the largest — are closely tied to the fate of the single sponsor that created and funded them.

4.10.2 One valuation or two?

As noted above, SEPPs are currently required to prepare both going concern and solvency valuations and to fund in accordance with whichever requires the highest contributions. Most countries with employment-based private pensions require only a solvency valuation for funding purposes, although a few jurisdictions outside Canada require a second form of valuation for information purposes. Some stakeholders argue that Ontario should adhere to the majority position and require only a single approach to both valuation and funding, while others endorse the use of a second valuation for information — but not funding — purposes.

In the case of SEPPs, however, a strong case can be made for continuing the present arrangement. As the driver of pension costs, solvency valuations and going concern valuations tend to alternate as conditions in financial markets change. During much of the 1990s, when somewhat higher interest rates and strong investment returns were prevalent, solvency valuations were quite low and would have required much lower contribution levels. If going concern valuations had not been in place, requiring enhanced contributions, many plans would have been in much worse financial shape when funding requirements based on solvency valuation became the norm during and after the "perfect storm" of 2000. Thus, the requirement for dual valuations and enhanced funding may explain why DB plans across Canada weathered the "perfect storm" better than their counterparts in other countries.

Moreover, it is not at all clear which of the two funding models should be retained, if either going concern or solvency valuations were to be abandoned.

Solvency funding has been criticized because it requires plans to prepare for scenarios that may never come to pass (imminent wind-up) and to prepare to fund obligations that may never eventuate (especially the cost of annuitization and pensions that are initiated before normal retirement age). Moreover, under solvency valuations, funding is significantly influenced by long-term interest rates, but these rates may be inappropriate, unrealistic or simply unmanageable, thus making plans hostage to events over which they have no control. And finally, solvency valuations may make pension plans appear to corporate decision-makers as more costly and volatile than they need to be.

But solvency valuations have their defenders as well. As noted, the greatest risk faced by SEPPs is indeed that the sponsoring employer will wind up insolvent. Solvency valuations force sponsors to face up to this fact by focusing attention on the payout rates and annuity costs associated with plan wind-ups, and requiring that contributions be adjusted accordingly. Moreover, in Ontario, the wind-up of an insolvent plan represents a threat not only to the interests of active plan members and retirees, but to those of the PBGF to which they will look for "insurance" if the plan fails. By minimizing the risk of such claims, solvency funding protects not only individual plans and beneficiaries but, by extension, all plans covered by the PBGF — and, in that sense, the integrity and reputation of the entire DB system. Finally, every Canadian jurisdiction requires both solvency and going concern valuations, with funding set at the higher of the two. For Ontario to adopt a fundamentally different approach on a matter of such importance would require more compelling reasons than I have been able to muster.

> **Recommendation 4-13** — Single employer pension plans should continue to fund according to both going concern and solvency valuations.

Once it is accepted that both valuations should be maintained, the analysis must focus on whether there should be substantive changes to either valuation method.

4.10.3 Tweaking the solvency rules: the tension between affordability and benefit security

Earlier in this chapter I identified a number of concerns about certain aspects of solvency valuation that permitted some plan liabilities not to be funded, or to be funded only partially and gradually. Among the matters identified were the smoothing of changing asset values and discount rates; the exclusion from funding of some benefits such as future indexation, certain plant closure and early retirement benefits; and prospective benefit increases. If ensuring benefit security were the only factor to be considered, the current solvency rules ought indeed to be amended to ensure that all potential liabilities, including benefit improvements, are fully identified and funded not just fully, but promptly. My earlier recommendations tend in that direction.

In addition, I was told on several occasions that the key to improving solvency funding is to shorten amortization periods. Suggestions ranged from "as close to immediate funding as possible" to three years instead of the present five. While these suggestions are attractive in principle, and consistent with my own analysis, if rigorously implemented they might well bring in their wake higher costs for sponsors and greater sponsor resistance to benefit improvements; greater volatility in funding and more extreme perturbations on corporate balance sheets; and increased transaction and regulatory costs, occasioned by the need for more frequent valuation filings and regulatory reviews. For these reasons, I have not accepted this approach.

Instead, I am attracted by an alternative approach that would require not just full funding — 100% of what is presently required under a solvency valuation — but an additional "security margin," or "provision for adverse deviation" (PfAD) as it is known in Quebec, where the idea is currently under development, and in other jurisdictions that have some experience with them, including the Netherlands and Switzerland. A security margin, or PfAD, would serve as a reserve against risks of all kinds. It might be calibrated to respond to the particular kinds of risks to which individual plans and plan types are most vulnerable; it might be modest or substantial in size; and it might be either optional or mandatory. Depending on the particular characteristics of a security margin adopted in Ontario — different PfAD models are under discussion across Canada and especially in Quebec — the additional funding costs to the sponsor might be modest or substantial. Accepting that extra costs would be involved, at least security margins, or PfADs, have the virtue of being easily calculable once a formula is decided, of being containable and predictable, and of possibly obviating the need for other detailed changes in solvency valuation rules.

The volatility in equities markets since 2000 has also heightened concerns over how well pension plans account for risks inherent in their investment strategies and, in particular, whether they are ensuring a match between their assets and liabilities. For example, a plan with a higher proportion of retirees drawing pensions than active members generating contributions might “match” the liabilities attributable to retirees with a greater investment in bond or bond-like instruments. The greater the degree to which fixed liabilities respecting retirees are matched with equities or other volatile investments, the greater the risk to the fund. Conceivably, solvency valuations could require sponsors with a significant asset–liability mismatch to either correct it or to pay extra contributions to the plan by way of an offsetting risk premium. This, indeed, is the intent of the PfAD proposal now under consideration in Quebec. On the other hand, a major drawback to asset–liability matching is that it is very expensive — perhaps prohibitively so for many plans. And it also has the potentially undesirable side effect of discouraging pension funds from investing in equities, to the detriment of capital markets.

Not all submissions concerning solvency funding involved changes that would enhance benefit security at a cost, large or small, to sponsors. On the contrary: a number of sponsor-side submissions insisted that the solvency rules should be made more flexible and that sponsors should be accorded some relief from solvency funding, either on an ongoing basis or under specified conditions. Many employer groups, and some pension professionals, emphasized the importance of flexibility in encouraging employers to persevere with their DB plans through an era of low equity prices and interest rates, and other adverse market conditions. Others suggested that more flexible funding rules might encourage sponsors to make more generous benefit improvements now in the hope and expectation that improving market conditions in the future will pay for them without the sponsor having to make additional contributions.

Several stakeholder submissions to the Commission favoured extending the five-year amortization period provided under current solvency valuation rules to 10 or 15 years in order to relieve sponsors from the funding pressures associated with the decline in long-term interest rates. The federal jurisdiction and Quebec have adopted this approach by providing temporary solvency relief to plans that comply with certain criteria through extensions of their amortization periods. And Ireland and the United Kingdom have moved toward greater funding flexibility, using somewhat different strategies.

All of these sponsor-side proposals designed to ease the rigours of solvency funding coalesced around the idea that if a concern for benefit security was allowed to overshadow a realistic appreciation of the need to maintain the affordability of DB plans, sponsors might react by closing or capping their plans. The result, I was warned, would be just the opposite of what was intended: a further weakening of the DB system. This is indeed an important reminder that my recommendations must strike a balance between the concerns of active members and retirees and those of sponsors, between benefit security and affordability, and between the present and future health of the DB system.

It strikes me that the fairest and most straightforward way to achieve that balance is to establish a security margin, or PfAD, earmarked for the explicit purpose of enhancing benefit security, but to do so at modest net incremental cost to sponsors. This would have the additional advantage of acknowledging the point made at the beginning of this chapter: because of normal short-term fluctuations in asset values and interest rates, and marginal changes in other factors, no plan is likely to be funded at precisely 100% at any given moment.

The formula used to determine the security margin should be as simple as possible in order to avoid generating significant compliance costs.

> **Recommendation 4-14** — Single employer pension plans should be required to maintain a security margin (or provision for adverse deviation) of 5% of solvency liabilities. This margin should be amortized over an eight-year period. The security margin should be deemed to be part of the plan surplus on wind-up, but not for other purposes.

In recognition of the enhanced security provided to plan members by this security margin, plans that are en route to achieving it should enjoy a longer amortization period.

> **Recommendation 4-15** — For plans that have achieved 95% of solvency funding, the normal amortization period for achieving the new required funding level, inclusive of the security margin, should be extended from five to eight years. For plans funded below 95%, the current amortization period of five years should continue to apply until such time as they become eligible for the extended amortization period.

4.10.4 The distribution of surplus on plan wind-up

Employers, active members and retirees have been engaged in conflicts over surplus use and distribution since at least the mid-1980s. The issue has sometimes been framed in theoretical terms to no conclusive effect, as I noted in section 4.2 above. It has been framed as a clash of legal regimes — the employment contract and plan documents embodying the intent of the sponsor, *versus* the law of trusts and the PBA, which protect the property rights asserted by plan members and retirees — with the latter securing a number of significant but not definitive victories. And it has been framed in political terms, most recently in 2002 when the government of the day was forced by strong labour and retiree opposition to withdraw legislation intended to resolve it. My sense — apparently shared and acted upon by most stakeholders — is that none of these approaches is likely to succeed, and that a pragmatic approach to surplus issues is the right one.

By way of context, the PBA provides that upon plan wind-up, the surplus should be dealt with in accordance with the terms of the plan documents. If those terms are not clear, the PBA creates a legislative presumption that the surplus should be distributed to the plan members. Subsequent regulations enacted under the PBA apparently permitted surplus to be addressed by a surplus-sharing agreement entered into between the sponsor and the union representing plan members, or, in the absence of a union, two-thirds of active members and a situation-specific proportion of retirees. However, as a result of the *Tecsyn* decision (2000), employers have had to establish their clear entitlement to surplus both under the plan documents and under a surplus-sharing agreement. This has meant, in effect, that sponsors have had to secure a court determination of their entitlement under the plan documents, often with the explicit consent of both active and retired members, in order to persuade the Superintendent to permit the distribution of surplus in accordance with the surplus-sharing agreement. This process seems unnecessarily cumbersome, time-consuming and expensive. It should be changed.

Three broad alternative approaches are possible. First, existing plans could be required to amend their documents to resolve the issue by clear language, as new plans are already required to do. However, this approach is likely to lead to disputes if members object to the sponsor's proposed amendment. Second, a default rule could be laid down in the legislation overriding plan documents and assigning surplus to either the sponsor or the plan beneficiaries, or dividing it between them in fixed proportions and/or by priority. This approach would likely be controversial. Or third, legislation might mandate the distribution of surplus in accordance with a clear plan document or under a surplus-sharing agreement, subject to recourse to some dispute resolution process in the event of disagreement. Ontario stakeholders have become familiar with this third approach; they appear to favour it and it seems to work well, or at least it would if a more efficient dispute resolution process were available.

> **Recommendation 4-16** — If a single employer pension plan is in surplus on being wound up, the surplus should be distributed in accordance with the plan documents unless the parties agree, or the proposed Pension Tribunal of Ontario rules, that the documents are not clear. In the event of such an acknowledgement or ruling, the sponsor may propose a scheme for the distribution of surplus, which would take effect if approved in one of two ways:
>
> (a) if plan members are not represented by a union, the proposal should be submitted to a vote by secret ballot of the plan members and retirees, and would take effect if approved by two-thirds of those voting; or
>
> (b) if plan members are represented by a union or other organization, the sponsor should submit its proposal to representatives of the active members and retirees with a view to concluding a surplus distribution agreement.
>
> If the sponsor and the representative negotiators cannot reach agreement, they should submit the matter for determination to a dispute resolution procedure of their own choosing. If they cannot agree on such a procedure, or if it does not resolve the matter within a reasonable time, any party may apply to the Superintendent to refer the matter to the Pension Tribunal of Ontario, which would then establish the terms of the surplus distribution agreement.
>
> Any scheme approved by secret ballot, any surplus distribution agreement reached by representative negotiators, and any determination by the Tribunal or an agreed dispute resolution procedure would be final and binding on the Superintendent and on all persons claiming to be entitled.

4.10.5 The distribution of surplus in an ongoing plan

Ongoing plans may find themselves in a surplus position for many reasons. In accordance with Recommendation 4-14, which contemplates the establishment of a security margin in every plan, the first 5% of any excess should be set aside for that purpose; any excess over that margin should be considered surplus.

Like surplus in plans being wound up, surplus in ongoing plans has been the subject of frequent controversy. Plan members will naturally wish to see it retained in the plan to enhance or to index plan benefits, or to provide a further buffer — over and above the 5% security margin — in the event that the plan suffers reverses in the future. Sponsors may on occasion acquiesce in the views of active members and retirees, but often have other ambitions for the surplus. Sometimes they will want to withdraw the funds in order to use them for general business purposes or to pay plan expenses; more commonly, they will want to take a contribution holiday in order to treat the surplus as a credit against contributions they would otherwise be obliged to make.

Contribution holidays, which are lawful in the United States, the United Kingdom, and all Canadian jurisdictions, including Ontario, are clearly legitimate in appropriate circumstances so long as they do not compromise the solvency of the pension fund. Nonetheless, they are controversial. Anecdotal evidence provided to the Commission suggests that some sponsors took contribution holidays on the basis that their last triennial valuation permitted this, even though their funded status had since deteriorated to well under 100%. A research study prepared for the Commission by Jinyan Li notes that a limited review of federally regulated plans identified no "observable" relationship between funded status and contribution holidays, and that 45% of under-funded plans would not have been under-funded had they not taken contribution holidays.

This somewhat limited evidence suggests that contribution holidays ought at least to be made more transparent. Recommendations to this effect are found in this chapter, in Chapter Five and elsewhere. In addition, measures ought to be introduced to prevent the initiation or continuation of contribution holidays based on a previous triennial valuation when plans have, in the meantime, become seriously under-funded. Of course, these measures ought to take account of the possibility of rapid changes in a plan's funded status and of the difficulty of estimating that status without subjecting the plan to a full valuation. They ought to be designed so as to trigger sensible action to preserve the fund and to discourage deliberate or wilfully negligent disregard for its security.

Controversy over the sponsor's access to surplus in an ongoing plan extends to its use to pay plan expenses. In principle, I see no reason why the payment of plan expenses, including PBGF premiums, should not be permitted under the same circumstances and subject to the same conditions as contribution holidays.

> **Recommendation 4-17** — Plan sponsors should be entitled to reduce or omit their contributions to a plan in any year in which it is funded at 105% or more of its solvency liabilities. However if — based on benchmarks to be developed by the regulator — a plan administrator knows, or ought reasonably to know, that funding has fallen below 95%, the administrator should immediately notify the sponsor to resume contributions until the plan is again funded at 105% of solvency liabilities. The pension regulator should develop benchmarks based on the plan's annual financial statements that will enable plan administrators to determine when contributions should be resumed.

> If the regulator finds that a contribution holiday was improperly taken or continued, any contributions withheld from the plan should become immediately due and payable, together with interest, regardless of the plan's present funded status, and the sponsor should be subject to an administrative fine of up to $1 million, or double the amount withheld during the improper contribution holiday, whichever is less. The improper use of plan surplus to pay the expenses of the plan, including PBGF premiums, should be treated in similar fashion.
>
> The parties to a collective agreement should be free to negotiate other arrangements for the use of surplus in an ongoing plan. These arrangements should prevail notwithstanding those proposed in this recommendation or established in the plan documents.

Debate over the use of surplus in an ongoing plan has also surfaced in the context of proposals to use plan surplus to fund the merger, division or conversion of existing plans, or to subsidize the creation of a DC or hybrid plan. These issues are addressed in Chapter Five.

Finally, the sponsor's right to simply withdraw surplus from an ongoing plan is an issue about which feelings run particularly high. However, it is a rare occurrence because, under current law, withdrawal requires the consent of every plan participant plus the maintenance in the plan of a buffer in excess of full funding of two years of current service costs, or 25% of plan liabilities, whichever is the greater. In general, I am reluctant to encourage the withdrawal of surplus from ongoing plans that may experience future difficulties from time to time. However, while I accept that the required buffer is an appropriate deterrent to reckless behaviour, I am also concerned that the present constraints on withdrawal are so severe that they may produce perverse results. On the one hand, sponsors may be reluctant to fund plans beyond legally permissible minimum levels if, as a practical matter, they are precluded from recovering any part of the surplus. On the other, the virtual inaccessibility of surplus may prompt sponsors to accomplish the same result by other means: to press for valuations that minimize their contributions, to take inappropriate contribution holidays or to overstate expenses to be paid out of the plan. I therefore propose some modification of the present rules on surplus withdrawal.

> **Recommendation 4-18** — Sponsors may apply to withdraw surplus from an ongoing plan pursuant to the procedures set out in Recommendation 4-16, provided that the plan remains funded subsequent to withdrawal at 125% of full solvency funding, or 105% of full solvency funding plus two years of current service costs, whichever is greater.

This recommendation involves two departures from the *status quo*. First, it lowers the required level of consent by beneficiaries (absent a union) from 100% to two-thirds of those voting. This requirement ensures that while a significant minority of members can still block a withdrawal, a few individuals cannot. Of course, if a union is present in the workplace, any decision concerning surplus withdrawal must be taken with due regard for its right to negotiate on behalf of all bargaining unit members.

Second, and more importantly, the recommendation establishes that the sponsor may withdraw surplus from an ongoing plan on the basis of clear plan documents. This possibility not only rests on the principle that clearly articulated rights ought to be respected, it is accompanied by a number of safeguards to protect plan members: the high threshold for withdrawal; the right of the union to use its bargaining power to negotiate superseding arrangements well in advance; the possibility of challenging the sponsor's claim that the plan documents are clear; and the improved negotiation and dispute resolution process provided in recommendation 4-16.

To my mind, the possibility of properly controlled surplus withdrawal provides sponsors with a carrot — a small carrot — to complement the substantial stick of enhanced funding requirements and tighter controls on contribution holidays. I believe that it will give sponsors some confidence that they can fund well over the minimum required by law to the general benefit of all plan members, and that it will prejudice only the very few plan members who might otherwise be able to extract some surplus from the sponsor as the price of agreeing to withdrawal of surplus in the rare circumstances that a plan finds itself funded at above 125%.

4.11 Annuity Rates

A number of stakeholders focused on annuity rates as a problematic aspect of solvency valuations. A key element driving solvency valuations is the price that plans might have to pay to purchase annuities for their active members and retirees in the event of a wind-up. When long-term interest rates are low, as they are now, assumed annuity costs used in solvency valuations are high. Moreover, they are kept high by the fact that under current regulations, annuities may be purchased only from Canadian insurance companies. Since relatively few companies are available to provide them, the supply of annuities is limited and the cost of annuities is higher than it might otherwise be under fully competitive market conditions. The situation would become even more difficult if a number of large pension plans were actually required to purchase them at the same time. The net result, I was advised, is that upward pressures on solvency valuations attributable to annuity costs make it cheaper to simply keep plans open and in operation than to annuitize benefits and close them. This situation may serve neither sponsors nor beneficiaries over the long term.

Several suggestions were advanced for avoiding or reducing the cost of annuities. These included creating a publicly funded non-profit annuity pool for pensions; removing the requirement of annuitization on wind-up and allowing for lump sums to be paid and invested as the active or retired member wishes; and allowing a private or public agency to handle stranded pensions, thus obviating the need for them to be annuitized and, presumably, reducing both the demand for annuities and their price. Such changes, it is argued, would make pension funding less volatile and more affordable by detaching funding valuation from annuity rates. In Chapter Five I address these concerns by recommending the creation of an agency to handle stranded pensions.

> **Recommendation 4-19** — Ontario should investigate strategies for reducing the cost of annuities and the influence of the annuities market.

4.12 Indexation

As is well known, inflation, even at modest rates, can erode the real value of pensions. In order to protect retirees from this harm, some plans provide that pensions will be adjusted according to a formula, usually agreed in the course of collective bargaining; others provide that the sponsor in its discretion may adjust the pensions from time to time; and still others are simply silent on the issue.

Representatives of active members and retirees have argued that sponsors should not have access to surplus unless adequate provision has first been made for indexation. They note that surplus arises, in part, due to growth in the nominal value of plan assets, some portion of which may be attributable to inflation, which, ironically, at the same time undermines the purchasing power of pensions. On this basis, as well as on other grounds, they claim to be entitled to some or all of a surplus in order to fund improvements in the plan — including indexation.

This issue of indexation was carefully canvassed by the Friedland Task Force, appointed in 1986 following periods of runaway inflation in the mid-1970s and early 1980s. The Friedland Task Force recommended a formula by which some proportion of the increase in asset values would be used to provide indexation — and in fact, legislation to this effect was enacted, though never proclaimed in force or implemented by regulation.

Employers do not accept this analysis. They see surplus as arising from investment growth, which may be attributable to a superior investment strategy, and from higher-than-needed sponsor contributions — especially in recent times, when significant payments have been required to meet solvency rules. They argue that, at a minimum, surplus attributable to either of these causes ought not to be appropriated to provide inflation protection, and that at a maximum, if inflation protection is neither expressly provided in the pension bargain nor funded on an ongoing basis, it ought not to be imposed *ex post facto*.

This latter argument may have legal merit, but like the other arguments against indexation, it does not address an important social problem. There can be no doubt that even modest inflation over the long term generates difficulties for all persons on fixed incomes, including retirees. And there can be no doubt that for people retiring today, the long term is likely to be longer than it used to be. However, providing this enhanced income certainty for active and retiring plan members would translate into significantly increased costs and uncertainty for plan sponsors. Sensible retirement planning and pension design should provide for indexation, even if it means reducing the initial value of pensions in order to maintain their purchasing power into the future. But should sensible planning and design be required by law — either prospectively or retrospectively? Given the cost and risk implications, and their potential destabilizing effects on the whole DB pension system, this is not a step to be taken lightly. Nor is the problem confined to the DB system. Recipients of DC pensions and individuals who save for retirement in other ways also confront a likely decline in their standard of living over the long term due to inflation. So do DB members who happen to be enrolled in plans that are not in surplus.

A minimal or initial response to the problem of indexation is to make it more visible and urgent by forcing sponsors and unions — if not individual plan members — to face up to the long-term consequences of not providing it. This can be accomplished in part by providing active members and retirees with timely and accurate information.

> **Recommendation 4-20** — Every plan should contain a clause stating explicitly what provision, if any, has been made for the indexation of benefits and for the funding of indexation. Each triennial valuation and each annual statement provided to the regulator, active plan members and retirees should provide the same information.

This approach has several advantages. It alerts beneficiaries to an important positive or negative feature of the pension bargain; it potentially brings pressure to bear on their union, if they have one (some three-quarters of all DB members do), in order to address the indexation issue through collective bargaining; it forces the negotiating parties to confront the hard choice between higher current pensions and pensions whose value will endure over the long term; and it is more consistent with the voluntary character of Ontario's pension system than the other solutions proposed. Indeed, some plans have begun to address indexation by various contingent benefit formulae. For example, indexation may depend on fund performance and/or the plan's ability to pay — innovative approaches that should receive further study.

At best, however, this reliance on disclosure and experimentation would provide gradual movement toward some sort of solution for most plans and beneficiaries. Unfortunately, it has several serious defects. First, it would not help plan members who have no union representation. Second, unions and their members may be reluctant to sacrifice current gains for future indexation, especially if the benefits of indexation accrue to retirees who no longer have a voice in union deliberations and cannot participate in collective action to help the union achieve its bargaining goals. And third, it does not deal with situations of unusually high and rapid inflation, such as the one that led to the appointment of the Friedland Task Force. This last defect, at least, can and should be overcome. Ontario should not — as it did in the 1970s and 1980s — find itself in the position of being unable to deal with the effects of an "inflation emergency" on the pension system.

> **Recommendation 4-21** — The government should proclaim in force the provisions of the *Pension Benefits Act* that allow it to require that pensions be inflation-adjusted in accordance with a formula to be prescribed. That formula should be restricted to "inflation emergencies."

Indexation is a classic example of how difficult it is to address long-term issues of fundamental importance to Ontario's pension system in the context of debates over more immediate, practical and controversial policy issues. Discussion of indexation is essential, and I hope that the Pension Champion, whose establishment I recommend in Chapter Ten, will ensure that this issue engages the attention of stakeholders and the government.

4.13 Letters of Credit and Asset Pledges

Many sponsor representatives proposed that using fully secure alternative forms of assets could facilitate the funding of plans under certain circumstances. One such asset is the letter of credit. If a sponsor is creditworthy, it could obtain a letter of credit from a bank — in effect, a promise to pay the fund an agreed sum if the sponsor defaults on a scheduled contribution payment. The letter of credit could be made "callable": if the sponsor is unable to renew the letter of credit because it cannot pay the bank charges or because its credit rating has deteriorated, the bank becomes legally obliged to pay the full value of the letter of credit into the fund. The federal jurisdiction, Quebec, Alberta and British Columbia now allow letters of credit on different terms up to different maximum amounts and for different periods of time. The United Kingdom imposes few specific limitations on letters of credit but requires that the plan trustees be satisfied with the security provided. During the relatively brief period since their inception, letters of credit do not appear to have generated difficulties in any of the jurisdictions that have adopted them.

However, several objections have been expressed to the use of letters of credit: that they will not generate investment growth for the pension fund; that the existence of a letter of credit in favour of the pension fund might prejudice a union's position in negotiations resulting from a sponsor's insolvency; that they may be used to defer much-needed payments into the fund; and that they would be unnecessary if surplus rules were tightened up.

While these objections are understandable, given the relative novelty of letters of credit in the pension context, I do not ultimately find them persuasive. On the contrary, I am convinced that letters of credit can be drafted in such a way as to allay any concerns. They strike me as potentially useful tools that would allow corporate sponsors to retain their capital for business purposes for finite periods of time while fully protecting the financial interests of the fund. Indeed, since banks will provide a letter of credit only to a credit-worthy company, their willingness to provide one following a credit assessment of their client — the sponsor — constitutes a strong signal that the sponsor is, in fact, solvent. Conversely, if the bank decides to call the letter of credit, this would amount to a warning to the pension regulator that both the sponsor and the plan may be in difficulty.

> **Recommendation 4-22** — Irrevocable letters of credit should be permitted as security for a fixed proportion of contributions owing to a plan, and for a maximum period of time, provided they are enforceable by the plan and immune from inclusion in the sponsor's estate in the event of insolvency. The Superintendent should have no power to relieve against these requirements either before or after the fact.
>
> After five years, experience with letters of credit should be reviewed by the regulator. If no difficulties are found, they should be made available as a permanent feature of pension funding in Ontario.

The United Kingdom also permits the use of asset pledges as security for debts owed to pension funds under specified circumstances. Pledgeable assets might include land, bonds or other easily marketable goods. To be acceptable for this purpose, assets would have to be independently, objectively and conservatively valued and be made fully available to the pension fund in the event the sponsor defaults on payment.

> **Recommendation 4-23** — Ontario ought to investigate the possibility of permitting the use of asset pledges to provide security for unpaid contributions to pension funds, and to define the purposes for which, and the conditions under which, such pledges might be used. If asset pledges seem useful for sponsors, safe for pension plans and capable of being overseen by the regulator, their use ought to be allowed for an initial period of five years, subject to renewal on a permanent basis if experience warrants.

4.14 The Influence of Federal Law on the Funding of Pensions

4.14.1 Introduction

While my mandate requires me to report to the Minister of Finance for Ontario, and while it clearly contemplates that I will confine myself to matters within provincial jurisdiction, I heard from a number of stakeholders that improvements in funding practices and in the financial viability of occupational pensions in Ontario depend in some measure on changes to federal law. In the analysis and recommendations that follow, I therefore propose that the Honourable Minister make representations to his federal counterpart, seeking such changes. I have good reason to believe that these changes would be widely welcomed by members of the pension community across the country.

4.14.2 The *Income Tax Act*

The federal *Income Tax Act* (ITA) and the rules and regulations made under it have significant implications for pension plans. These rules limit the maximum benefits that can be paid out of, and the maximum contributions that can be paid into, a pension plan in order for it to qualify for favourable treatment under the ITA. I was told on numerous occasions that both limits are too low.

The tax-incented benefit levels in Canada are a fraction of benefit levels in other countries, making DB plans less attractive to employees with above-average levels of income, and therefore, perhaps, less attractive to corporations generally. The contribution limits are 110% of liabilities, in most circumstances. It is widely accepted that these limits have had a negative effect on funding over time, as they prevent a reasonable amount of surplus from accumulating in good economic times to carry the plan through more difficult periods. In addition, in 1991, the ITA was amended to remove the preferential tax treatment previously afforded to DB pension plans. Some observers suggest that, given the superior qualities and public policy benefits of DBs, tax policy should once again encourage DB plans and those with similar characteristics.

While such proposals inevitably involve tax expenditures, these are to an extent offset by the reduced claims made by DB retirees on government income support programs and the greater expenditures they make (and the multiplier effects they generate) when they spend their pensions on goods and services. These are good public policy reasons to encourage DB and like plans.

> **Recommendation 4-24** — The Ontario government should endeavour to persuade the federal government to increase benefit and contribution levels for registered pension plans under the *Income Tax Act*, and to consider policies that encourage participation by workers and employers in DB plans or their functional equivalents.

4.14.3 The impact of the *Pension Benefits Standards Act* investment rules on pension plan investment strategies

The investment strategy of a pension plan is a critical aspect of its funding. Valuations, contributions and ultimately, benefit security, are all significantly affected by a plan's investment profile and performance. Moreover, as outlined in Chapter Two, the cumulative effect of pension plan investments constitutes a powerful influence on Ontario's capital markets and economy.

The investments of registered pension plans in almost all provinces are governed by investment rules enacted under the federal *Pension Benefits Standards Act* (PBSA) and then incorporated by reference into provincial pension regulations. These rules prohibit pension plans from directly or indirectly:

- holding more than 30% of the voting shares of a corporation;
- holding more than 5% of the book value of a single Canadian (but not foreign) real estate company, or 15% of a group of Canadian (but not foreign) real estate properties;
- holding more than 25% of the book value of Canadian (but not foreign) resource companies;
- holding more than 10% of the shares of any particular company or group of companies, except through a segregated, mutual or pooled fund that complies with certain requirements;
- lending money to a related party, including the plan sponsor; and
- holding shares of a related party, including the plan sponsor, unless obtained on a public stock exchange or as needed for the operation of the plan.

By contrast, and layered on top of these specific requirements, the Ontario's PBA sets a general standard for investment decisions: a plan administrator is required to "exercise care, skill and diligence" and to demonstrate "the prudence of an ordinary person holding the property of another" in the investment of the pension fund.

Both to the Commission and in other forums, a number of major Ontario pension plans have raised significant concerns about the federal investment rules. In their view — and in that of other observers, as well — some of the federal rules, such as those that seem to favour foreign over domestic investments, are misconceived. Some rules are inconsistent with the desire of major plans to become active rather than passive investors; and some — more by accident than design — seem to inhibit attempts to generate optimal returns for the benefit of pension plans and their members. In addition, the federal rules are seen to diminish the potential contribution of these important institutional investors to capital markets. Nor are major plans alone disadvantaged. If, as I recommend in Chapter Nine, small pension funds were provided with the means to pool their resources to achieve better investment outcomes at lower costs, the federal rules would affect them adversely as well. Finally, it is widely believed that plans find ways to do what the investment rules prevent. If so, not only are the rules subverted, but so too is general respect for the law. These are all good reasons to change the rules, but the federal government has so far declined to do so.

Would it suffice for the federal government to simply repeal its investment rules, or for Ontario to declare that it is no longer bound by them? I think not. Ontario's "prudent person" rule, as it stands, is very vague. More explicit guidance is needed: the meaning of "prudence" should not be left so broad that it has no normative power, nor should it have to be determined after the fact in expensive litigation. On the contrary, clear rules ought to lay down at least the main principles governing investment decisions. For example, plans should be prevented from "putting all their eggs in one basket" or, as in the federal rules, from investing in the sponsoring corporation (unless through a public exchange and within the diversification limits), or from engaging in other forms of self-dealing. These general rules might then be refined — perhaps through information bulletins or interpretative rulings — so that they speak to potential problem areas such as employer-administered SEPPs or union-administered MEPPs, which may be tempted to invest their funds with a view to advancing their collective bargaining or job creation strategies, rather than maximizing the pension plan's investment returns.

The aim should be to enable funds to pursue prudent and profitable investment strategies commensurate with their resources and capacities; to prevent investment practices that might place pension plans at unacceptable risk; to avoid plans having to engage in convoluted or unseemly manoeuvres in order to undertake normal, responsible marketplace behaviour; and to accomplish all this with a minimum of direct, bureaucratic control.

Ideally, there should be Canada-wide consensus on a new set of investment rules, which suggests that the federal government ought to take the lead in formulating them. In the absence of such action, Ontario can and should adopt its own investment rules, which might continue to incorporate by reference, or to simply reproduce, some of the federal rules, omitting only those to which it objects. Or, as suggested above, the province might build on its "prudent person" rule. Finally, a reconstructed pension regulator, as proposed in Chapter Seven, might provide greater guidance to plan administrators on what it regards as inappropriate investment behaviour, both in the form of information bulletins and by way of advance rulings to plans embarking on novel investment strategies.

Pension plans must also take steps to adapt to a future in which they may be given greater latitude than they presently enjoy. Those steps must begin with a serious assessment of the implications of any transition from passive to active investment practices, and they must involve greater capacity for fund management and risk assessment. And of course, there must be transparency in the adoption of new policies and in accountability to plan beneficiaries for their success or failure. I return to this issue in Chapter Eight, where I deal with the so-called 30% rule that limits the ability of pension plans to become actively involved in the management of enterprises in which they have a significant or dominant ownership position.

> **Recommendation 4-25** — The Ontario government should endeavour to persuade the federal government to reform the federal investment rules and, in particular, to remove or amend particular quantitative restrictions that no longer make sense, such as those involving prohibitions on Canadian, but not foreign, investments.
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> However, if the federal government does not do so within a reasonable time frame, the Ontario government should cease to rely on the federal regulations and establish its own investment rules, tracking the federal rules only to the extent that doing so is deemed good public policy in Ontario.

Finally, interest in socially responsible investment (SRI) has been evolving over the last decades to the point where many pension plans have investment policies that consider SRI issues. A number of European states now require that corporate boards and bodies like pension trustees disclose their SRI policies, if any. It seems to me these are not only positive, but likely inevitable, directions for investment practice, and should be acknowledged. This issue is addressed in greater detail in Chapter Eight.

CHAPTER FIVE – PENSION PLANS IN A CHANGING ECONOMY

5.1 Introduction

In Chapters Two and Three I described how economic, labour market and other changes have influenced pension plan coverage. In this chapter I explore how these same developments have affected the rights, interests and expectations of sponsors, active plan members and retirees.

As noted in Chapter Three, the manufacturing sector has been transformed: employment levels have dropped considerably; job tenure has become shorter and less secure; plants have closed; and companies have been taken over, merged and reorganized, or gone out of business. These tendencies, evident for several decades, have been accelerating recently, especially in the domains of steel and auto production. As a result, pension plans — especially single-employer pension plans (SEPPs), closely tied to the fate of the sponsor company and especially prominent in those two domains — have experienced a series of dislocations. The service sector, though it has expanded considerably, has also experienced significant restructuring, as have the public and broader public sectors — notably in the late 1990s — as various elements were privatized, eliminated, amalgamated or transferred from one level of government to another. These changes in the service and public sectors have also produced discontinuities in the operation of many pension plans. Nor is transformation of the economy and of public administration likely to subside any time soon. Nor are the consequential challenges for pension plans.

Some parts of the pension community have developed structures to cope with these challenges. For example, the construction industry is characterized by considerable volatility: small- and medium-sized firms come and go; employment levels fluctuate in response to the seasonal and cyclical demand for labour; and the duration of a job for any given worker with any given firm tends to be measured in weeks or months, not years. Nonetheless, in this unpromising pension environment, an answer has been found: the multi-employer pension plan, or MEPP. Each unionized construction company pays into a central pension fund a fixed sum per hour worked by each employee. The fund trustees, often appointed by the union, manage all aspects of the plan, and employees can be assured of pension coverage no matter which employer they work for, or how briefly, or whether that employer is still in business — so long as they continue to work in the construction industry, or at least its unionized segment.

The solution is not perfect. In the case of a long-term decline in construction, large numbers of employers may go out of business or the unionized sector of the industry may shrink; this would confront the MEPP with a serious risk of under-funding and, ultimately, of wind-up. Nonetheless, the MEPP remains a relatively flexible vehicle for pension provision in a context where change is a constant. The hospital, school board, community college and municipal segments of the broader public sector, also dominated by MEPPs, have found somewhat different, but relatively satisfactory, ways to cope with the dynamics of change that do not put the fundamental structure of their pension plans, or the interests of their members, at risk.

Private sector SEPPs, by and large, have not. In the context of a rapidly changing economy, single employers with pension plans may close plants; combine, divest or shut down particular units or functions; merge with, acquire or be acquired by another business; or simply cease to exist. Each of these relatively common occurrences may expose SEPP sponsors to complicated, protracted and expensive proceedings, and their workers to less secure and generous pension outcomes. Thus, plant closures and other forms of retrenchment involving mass layoffs may trigger the partial wind-up of a SEPP and, under present law, claims for "grow-in" rights by some workers whose pension expectations have been adversely affected. Corporate mergers, acquisitions and re-organizations may require the split or merger of pension plans and the consequent transfer of their members, liabilities and assets — sometimes several times over. Employees who experience discontinuities in employment due to corporate restructuring and downsizing — as more and more do, more and more often — may leave behind them a trail of small, stranded pensions whose cumulative value is much less than the value of a single pension with one employer might have been if circumstances had permitted.

Not all aspects of restructuring are harmful. Changes in corporate structure or reconfiguration of corporate operations may signify successful adaptation to market conditions, enabling companies to survive and grow, with obvious benefits for their workers. The redeployment of workers from one job to another, by choice or necessity, may be good not only for the economy as a whole, but sometimes for the workers themselves, as they move from declining to more successful enterprises where their long-term job prospects are better. And on occasion, pensions can actually facilitate change, as they do when they are used to fund early retirement for redundant workers. However, the architecture of our pension system and the regime that regulates it sometimes not only fail to facilitate or accommodate change, but actually complicate or obstruct it. In a sense, this is not surprising. Defined benefit (DB) plans were intended to ensure that workers remain with their employer for the long term, not to make it easier for them to take jobs elsewhere; and workers who have been forced to find other work are not eager to oblige their former employer by relinquishing any part of their pension rights.

The issue confronting me, then, is how to ensure that all pension interests are appropriately protected in the event of a change in business ownership, structure or operations. This involves three different projects: enhancing the regulator's capacity to deal with the pension consequences of corporate restructuring; improving pension outcomes for workers affected by restructuring; and resolving issues related to the design and funding of plans that are raised by various forms of restructuring. These issues are dealt with in succeeding sections of this chapter. A final issue — what happens when sponsors or plans fail? — is dealt with in Chapter Six.

5.2 Enhanced Institutional Capacity to Cope with Change

5.2.1 More efficient regulation for sponsors

Ideally, pension plans should not be a major consideration in corporate re-organization — or at least, the regulation of pension plans should be as neutral as possible in this respect. Parties to the transaction should be as free as possible to order their businesses and pension plans so long as they respect the rights and the interests of all stakeholders.

However, as we heard from various stakeholders, and as Lorne Sossin's research study for the Commission confirmed, regulatory proceedings resulting from corporate restructuring are uncertain, complex and, above all, lengthy. Over the last five years the median times required by the Financial Services Commission of

Ontario (FSCO) to complete processing of restructuring-related transactions were: 231 days for wind-ups, 481 days for partial wind-ups, 928 days for mergers and 1,165 days for asset transfers. Such delays are unacceptable. They interfere with corporate transactions necessary for the transformation of Ontario's economy. They prejudice the interests of employers, active members and retirees. They consume FSCO's resources and divert its energies from other regulatory tasks. And — given that it takes four times as long to merge plans, and five times as long to transfer assets as it does to wind them up — these delays provide corporate deal-makers with a plausible rationale for simply terminating plans altogether.

I am not sure whether these delays are caused by the intrinsic complexity of the law governing particular transactions, inappropriate statutory procedures, litigiousness or foot-dragging by the parties or administrative inefficiency. However, I am sure that something must be done rapidly to rectify the situation.

> **Recommendation 5-1** — The pension regulator should immediately investigate the causes of extreme delays in approving transactions, including splits, mergers, asset transfers and conversions, and provide a report that can be used to facilitate the processing of such transactions in accordance with the recommendations of this Commission.

Such a report will be an important complement to the recommendations in Chapter Seven, which are intended to streamline the regulator's decision-making and appeals processes, and regularize the provision to stakeholders of advanced rulings and guidance bulletins.

5.2.2 More choices, better outcomes for workers

Portability remains a problem for workers with pension coverage who move to another job, whether by choice or necessity, and whether individually or in groups. Essentially, when they move they have three choices: to leave their pension stranded with their former employer until they reach retirement age; to try to persuade their new employer to allow them to use the assets from their original plan to "buy in" to the new employer's plan; or to take the commuted value of their original pension in the form of a locked-in RRSP, which will become available to them upon retirement. In addition, if their previous plan has been partially or wholly wound up, their deferred pension entitlement must be annuitized. All four scenarios have serious disadvantages for employees who find themselves in this situation. The first would result in their pension being calculated on the basis of their truncated service with the original employer; the second depends on the existence of a pension plan in their new place of employment and on the willingness of their new employer to give them credit for past service; the third means that their funds are not likely to be actively managed as part of a large investment pool and will potentially grow more slowly over time than if they had remained in the original plan; and the fourth — like the third — cuts them off from sharing in future growth in the plan's investments that may be used to fund ad hoc benefit improvements. These difficulties are compounded as employees are having to change jobs — even careers — more and more frequently during the course of their working lives, and they are most extreme in sectors undergoing rapid and fundamental restructuring, especially those where pensions are provided through SEPPs.

As I discuss in more detail below, a number of simple changes can generate options for employees in "exporting" and "importing" plans. However, one option exists outside the current system that I believe would be a very useful addition to the system's architecture: the creation of a centralized pension agency to assist employees in consolidating past pension entitlements.

The idea is not a new one. In the early 1960s, the Ontario Committee on Portable Pensions recommended a number of reforms that have become part of our present system, including earlier vesting of pension rights and procedures governing the transfer of pensions. It also recommended the establishment of an agency "for the purposes, among others, of receiving, holding and disbursing pension benefits." In effect, the employee would be able to deposit stranded pension funds with this agency, which would manage them actively and, in due course, disburse benefits to the employee upon his or her retirement. The Committee's recommendation was, in fact, adopted in Ontario's original *Pension Benefits Act* (PBA) of 1963 (never proclaimed in force) and survives in the current version of the PBA, which empowers the Lieutenant Governor in Council to "establish or designate" such an agency.

However, no such agency has in fact been established or designated. Had it been, a number of additional and attractive options would now be available to deal not only with the pension consequences of corporate restructuring, but with portability and many other issues as well.

> **Recommendation 5-2** — The Lieutenant Governor in Council should establish an Ontario Pension Agency to receive, pool, administer, invest and disburse stranded pensions in an efficient manner.

I explore the possible uses of the Ontario Pension Agency (OPA) later in this chapter and in Chapter Six. First, however, a word about its structure and general mandate. The OPA could be established as an arm's-length Crown corporation, or operated under franchise by one or more private firms based in the pension industry or, indeed, through some form of public–private partnership — but there should be no long-term reliance on government funding. However organized, it should be able to sustain itself after an initial period by charging modest service fees to its "clients." The OPA would provide pension beneficiaries and sponsors with the option of depositing the assets of stranded pension funds with the agency, which would, in turn, invest and actively manage them. Upon retirement, the beneficiary would receive not the pension originally contracted for, but an earnings-related target benefit pension, calculated in a fashion roughly comparable to that used by the Canada Pension Plan. Conceivably, though it is not an essential part of the scheme, beneficiaries might be able to augment their initial stranded pension by depositing additional sums with the OPA by way of contributions from either subsequent employers or themselves.

While a host of important aspects of its mandate, design and operation remain to be determined, the OPA would:

- provide both the sponsors and recipients of stranded pensions with options not now available to them;
- ensure that beneficiaries can retain, augment and keep track of stranded pensions accumulated over their working lives;
- enable sponsors — with the consent of active plan members and retirees — to protect their pension entitlements without having to annuitize them following a wind-up or partial wind-up;
- relieve sponsors of the obligation to track former employees with deferred pensions;

- achieve economies of scale in administration and be able to pursue investment strategies not available to small plans or individuals; and
- relieve the plan administrator of some of the burdens now associated with plan wind-ups and partial wind-ups, including what to do with accruals for the benefit of former plan members who cannot be found.

These possibilities are explored in greater detail below.

5.3 The Effect of Restructuring on Active Members and Retirees

5.3.1 Introduction

When a business downsizes or changes its corporate form through sale, split or merger, the interests of plan members are directly, and sometimes prejudicially, affected. Their jobs may end or change; their pensions may continue for future service in a different plan; or accruals may stop altogether. It is important that the pension system ensure fairness for both active and retired members in these circumstances, both vis-à-vis the plan sponsor and in relation to each other. This can be accomplished in one of three ways: by encouraging employers with plans to accept incoming members with previous pension credits; by facilitating the transfer of assets between plans; and by offering employees a third option — to consolidate their pension assets and entitlements under the OPA, described above.

5.3.2 Encouraging plan sponsors to accept incoming members

In a voluntary system in which employers have the right to establish a pension plan or not, to determine the type and terms of the plan if they do initiate one, and to discontinue the plan so long as accrued rights are protected, it is difficult to impose on employers the obligation to accept new members or to credit them with benefits earned during their employment with a previous employer.

On the other hand, pension law already imposes a number of minimum standards and positive obligations on employers who do choose to maintain plans. These are found in the provincial PBA itself, the common law, and the federal *Pension Benefits Standards Act* (PBSA) and *Income Tax Act* (ITA). Consequently, it does not seem inappropriate to ask employers at least to formulate a policy on the transfer of pension credits from prior employment and apply it to incoming employees transparently and even-handedly.

> **Recommendation 5-3** — Sponsors should be required to develop a standard policy for dealing with newly hired employees who seek pension credit for service during employment with a previous employer. The policy should state whether such credit will be given and, if so, on what terms, and should be made available to all such employees.

In Chapter Ten, I propose that a number of non-statutory initiatives should be undertaken by a new Pension Champion, with a view to persuading the pension community to resolve long-standing problems that detract from the smooth operation of the DB system. Portability is one such issue, and it ought to receive priority attention.

5.3.3 Facilitating asset transfers from one plan to another

In most situations where an individual moves from one pension plan to another as a result of corporate or governmental restructuring, it would be optimal for pension service accruing before and after such a transaction to be consolidated into the new plan, for the individual's pension assets to be transferred from the old plan to the new, and for all ties with the previous employer to be severed. In many cases, this would serve the interests of both the employer and the individual. Such an arrangement is indeed possible where the "exporting" and "importing" plans — generally in the public sector — are parties to a reciprocal agreement under which an individual transferee is given the option to either remain in the former or transfer the aggregate value of his or her pension benefits to the latter. The value transferred buys a level of benefits, based on the cost of the benefits in the importing plan.

However, reciprocal agreements do not apply to group, as opposed to individual, transfers. Instead, group transfers are governed by provisions of the PBA that have been interpreted so as to allow service to be consolidated in the new plan only if it offers benefits that are identical to — or better than — those of the old. These requirements virtually foreclose the much more desirable approach of having the union that represents these workers negotiate the transfer arrangements on their behalf. True, the current provisions protect individual transferees who might otherwise make improvident choices and surrender particular benefits in their former plan (say, dependant benefits) that in the end would have been quite valuable to them. However, experience has shown that if aggregate value transfers are not allowed — if the requirement for exact matching between the two plans is maintained — asset transfers will seldom occur. As a result, significant groups of plan members are left with past service credits in one plan and new service credits in the other. This diminishes their pension benefits considerably.

Why individuals should receive more favourable treatment than groups is by no means clear. If — as many stakeholders propose — aggregate value transfers should be allowed for group transfers, despite some differences between the two plans, the rights and preferences of individual members can be protected by simply allowing them to opt out of the group transfer and remain in the old plan.

I believe that the present regulatory impediments to group transfers are inappropriate and should be changed.

Recommendation 5-4 — When individual or group transfers from one plan to another are contemplated, the importing plan should provide a detailed statement of the benefits to be provided. Each transferee should be given four options:

1. as a default option, to accept the asset transfer and begin future accruals in the importing plan, provided it offers benefits of comparable aggregate value to those provided under the exporting plan;
2. to remain as a deferred member of the exporting plan;
3. to transfer the value of the first pension to the Ontario Pension Agency; or
4. to transfer the value to a locked-in account.

If active plan members are represented by a union or similar organization, it may accept one option on behalf of all members, or allow each member to exercise one or more of the options provided.

The value of benefits provided by an "importing" plan should be deemed to be "comparable" to those provided by an "exporting" plan for purposes of the default option, if (a) approved by the Superintendent as approximating the aggregate collective value of such benefits, notwithstanding differences in the nature, value or terms of individual benefits, or (b) agreed to by a union representing active plan members affected by the transfer.

Some argue that the commuted value should always be used to measure the worth of transferred pension assets; others argue that doing so may price asset transfers too high or too low. In my view, the commuted value should normally be used unless a transfer agreement provides some other basis for measuring entitlements. However, I also note that since it is often in the new sponsor's interest to seek to maintain the continuity of operations by preserving the existing workforce intact, sponsors may offer or unions may negotiate a more generous basis for asset transfers. That said, if there is no transfer agreement, commuted values are probably the appropriate way to address the claims of transferees — whether groups or individuals — given the need to also address the entitlements of the remaining members and retirees under the original plan. Finally, if recommendations in Chapter Four are accepted, and MEPPs, JSPPs and jointly governed target benefit pension plans (JGTBPPs) are funded on a going concern basis alone, it will be necessary to develop some other basis for valuing asset transfers.

Problems associated with asset transfers have given rise to significant controversies in the public and broader public sectors. During the late 1990s, the provincial government "divested," or transferred, some 10,000 employees from one agency or level of government to another or to the private sector. Very few of these employees benefited from asset transfers. Indeed, some of them continued to do the same job in the same place, but were told that their future pension accruals would be in a different plan. These individuals will receive pension benefits that are lower than they would have been if all of their service credits and associated pension assets had been transferred to their new plan. Unfortunately, as noted, then- and still-prevailing rules preclude asset transfers if even relatively minor differences exist between the new and old plans.

The workers affected, their unions and many plan administrators involved in these divestments argued strongly for a change in the rules to allow asset transfers on an aggregate-value basis. Several administrators and sponsors, indeed, made submissions to the Commission to this effect, concerned that the affected workers were suffering hardship and unfairness. Now that many years have passed, and some of the workers affected have gone on to other jobs, retired or died, resolution of this issue has become more complicated and expensive. In some cases, the cost of giving active members full service credits in their new plans would exceed the value of past benefits. In others, the loss of service credits has been, in effect, offset by higher salaries in their new positions. In still others, plans have changed considerably from what they were at the time of the divestment or transfer.

Recommendation 5-4 addresses asset transfers on a going-forward basis, but is not meant to operate retroactively to dispose of claims by public sector workers who were adversely affected by past divestments. I do believe, however, that greater efforts must be made to address the residual effects of divestments in the public sector during the 1990s.

Some groups of divested public sector employees have negotiated agreements with their employers and plan administrators concerning the transfer of assets from their previous to their current plans. These agreements necessarily involve some give and take. While I am not in a position to evaluate any particular agreement, I would expect that each is tailored to suit particular circumstances; that each acknowledges other changes in the workplace bargain, including improvements in salary levels; that each aims to fairly balance the claims of the original and "imported" members of the plan; and that each takes account of other relevant considerations, including the capacity of the importing plan — and the government — to bear additional costs.

Negotiations conducted in good faith among the affected ministries, plans, unions and workers seem to be the most sensible way to resolve these issues. And since difficulties compound with the passing years, the time for negotiations is now.

> **Recommendation 5-5** — The government should promptly address the pension arrangements for groups of public service employees affected by past divestments and transfers, whether by allowing these groups to use the group asset transfer process proposed in Recommendation 5-4, or by other means, including negotiations with their representatives.

5.3.4 Enabling workers to consolidate their pension assets and entitlements

In Recommendation 5-2, I proposed that workers be enabled to rescue their stranded pensions and to consolidate pension entitlements earned in various jobs into a single account under the management of a new OPA. I now want to observe that this option should be available to them in addition to, rather than in lieu of, the other possibilities I have explored above. As the OPA develops a reputation for sound management and investment of pension assets, this option will become more and more attractive to plan sponsors, plan members and their unions.

> **Recommendation 5-6** — When a pension plan is being wholly or partially wound up, when a transaction provides the opportunity for a pension asset transfer, or when an active plan member leaves a job in which she or he has earned pension credits, active plan members and retirees should be given the choice of depositing the value of any pension accruals standing to their credit with the Ontario Pension Agency. Sponsors and unions negotiating the consequences of corporate or government restructuring should, by mutual consent, also be able to transfer plan assets to the Ontario Pension Agency in respect of some or all of the members affected.

Finally, under present law, there is no convenient solution to the problem of what to do with the assets of "lost" beneficiaries when a plan is being wound up. Similarly, there is no easy way for beneficiaries to locate pensions they left stranded in companies where they worked many years ago that may long since have gone out of business or acquired new corporate identities. It would be helpful if those beneficiaries had access to a register that would enable them to trace their "lost" pensions.

Recommendation 5-7 — The Ontario Pension Agency should receive and administer funds payable to pension beneficiaries who cannot be located. Plan sponsors should be obliged to file with the Ontario Pension Agency a list of all beneficiaries who cannot be located, and of all deferred members whose assets remain under the control of their plan. Plan members seeking to trace their stranded or deferred pensions should have access to this list.

5.3.5 Coming to terms with change: layoffs, plant closings, plan wind-ups and early retirement benefits

Unfortunately, when corporations curtail their operations, or go out of business altogether — as they often do in a changing economy — severe consequences may ensue for some or all active and retired plan members. Not only do active members lose their jobs, but all members must also confront the fact that their pension plan may be partly or wholly wound up, depending on whether the sponsoring corporation continues in business on a reduced scale, or closes down altogether. Many issues arise at this juncture, ranging from the right of members and retirees to claim any surplus in the plan to the consequences of the sponsor's insolvency and the possible failure of the plan. These issues are dealt with in Chapters Four and Six, respectively, but they are briefly revisited in this chapter. In the present context, however, the right of particular concern is one that affects the options available to workers who are in the process of losing their jobs: the right to early retirement.

All active plan members are entitled by law to early retirement on an actuarially equivalent basis at age 55, or 10 years before the normal retirement date in the plan. However, when an enriched early retirement option is provided under a plan, employees who have reached the specified age of eligibility may begin immediately to collect their pensions at a higher rate than the minimum required by law, according to the plan terms. For older workers, this is usually an attractive alternative to unemployment. Now for the point of contention: the PBA extends the benefit of such plan-based early retirement options to employees who are not yet eligible under the terms of the plan on a full or partial wind-up; they are given the right to "grow in" to early retirement if their age and years of service add up to 55 "points." Grow-in rights ensure that qualifying employees will receive undiminished early retirement benefits when they reach whatever age is stipulated in the plan.

Since grow-in rights raise somewhat different issues in the SEPP context, on the one hand, and in the MEPP and jointly sponsored pension plan (JSPP) context on the other, I deal with these two contexts separately.

Grow-in for SEPPs — Grow-in rights constitute a unique and valuable form of assistance to some older workers confronting unemployment due to plant shutdown and corporate closure. But not to all such workers: grow-in rights do not provide access to early retirement for individuals who might otherwise be eligible but lose their jobs other than through a full or partial wind-up of the company; they do not create an early retirement option for active members of plans that do not already provide one; and of course, they do not assist workers who have no pension plan at all. On the other hand, all workers who confront the loss of their jobs may benefit from contractual or *ad hoc* arrangements provided by sponsors voluntarily or under pressure from unions, and from statutory provisions for severance pay and termination pay, as well.

Should grow-in rights continue?

The Commission heard frequently that grow-in benefits can be very costly. In his study for the Commission, Brian FitzGerald provides examples of plans with enhanced early retirement benefits where the grow-in cost more than triples the burden on the plan of providing such benefits for individuals with 55 points who — in the absence of grow-in — would otherwise not be able to claim them. That said, plans have had to fund grow-in benefits for some time — at least since the advent of solvency valuation whose premise is that a wind-up has, in fact, occurred. The cost of funding grow-ins was perhaps not so evident until the late 1990s, when going concern valuations declined in importance, and solvency valuations became the primary determinant of plan funding. Now it is. It is evident to Nova Scotia — the only Canadian jurisdiction other than Ontario to provide grow-in benefits — which no longer requires them to be pre-funded. And it is evident to critics who contend that the requirement to provide and pre-fund grow-in has the perverse effects of privileging workers who are already privileged by being enrolled in a DB plan with access to early retirement, and of discouraging sponsors from providing any early retirement benefits at all.

On the other hand, many stakeholders clearly sympathized with the use of grow-in to provide redundant middle-aged and older workers with a bridge to early retirement rather than turning them loose on an inhospitable job market. Grow-in, they also note, helps to mitigate the effects of plant closings in single-employer communities where a large proportion of the workforce would otherwise suffer a precipitous loss of income.

While acknowledging the somewhat anomalous features of grow-in benefits, some stakeholders — including some sponsor-side actuarial firms — proposed that access to grow-in should be widened. This might be accomplished either by mandating compensation for lost access to early retirement benefits under the redundancy provisions of the *Employment Standards Act* or by making grow-in benefits available under the PBA to all workers who find themselves involuntarily terminated, whether as part of a mass redundancy or otherwise.

I favour the latter approach. It ensures fairness between different groups of plan members confronting essentially similar adverse circumstances. It also keeps pension issues within the exclusive control of the pension regulator.

> **Recommendation 5-8** — Existing “grow-in” rights that provide access to early retirement benefits for all qualifying single-employer pension plan members in the event of a full or partial plan wind-up should be extended to all such members who are involuntarily terminated. “Qualifying members” should continue to be those whose age and years of service add up to 55.

Implementation of this recommendation will likely lead to somewhat higher going concern liabilities for sponsors who have already assumed the additional expense of providing enhanced early retirement benefits in their plans. It would therefore be sensible for the new grow-in rules to be implemented after a transition period to allow sponsors to fund these added costs, or to make appropriate changes to their termination and early retirement arrangements — subject, of course, to their responsibility to negotiate such changes with unions representing their employees.

Grow-in for MEPPs and JSPPs — Currently, MEPPs are, in principle, subject to the PBA rules relating to grow-in benefits, and must fund them accordingly if a plan provides for early retirement. All MEPPs that addressed the point in their submissions maintained that, because they are at low risk of ever being partially or fully wound up, they should not have to provide or pre-fund the grow-in benefits that would ensue in those unlikely circumstances. In Chapter Four I rejected this very argument in connection with the effort of MEPPs to be relieved of solvency funding requirements. However, I did recommend for other reasons that they should be funded on the basis of going concern valuations only. Since grow-in funding pertains only to solvency valuations, if my earlier recommendation is accepted, the requirement for MEPPs and JSPPs to fund grow-in benefits would automatically cease.

A number of policy considerations reinforce this conclusion. First, active MEPP members share the risks of sponsorship and, in most cases, responsibilities for plan governance as well. Given these circumstances — a number of stakeholders argued — the benefit structure of MEPPs should be left to the parties to decide. If the parties wish to provide for enhanced benefits on a partial or full wind-up, they should be able to do so. If not, not. Second, MEPPs argued that sponsor contributions are capped for the duration of a collective agreement. During that period, if the plan experiences a funding deficiency, benefits must be adjusted to make it good. If grow-in benefits have to be provided as well, they will therefore be paid for not by the sponsor but, in effect, by those members (and retirees) who remain in the plan.

Finally, in "classic" MEPPs, like those in the construction industry, active plan members work out of the union hiring hall and are not committed to a long-term relationship with any particular employer. Consequently, their involuntary termination by an employer usually results not in those "terminated" employees becoming unemployed, but in their being reassigned to work for another employer covered by the same sectoral collective agreement and its related MEPP. Of course, if they are not reassigned — because there is no work or for other reasons — they may seek temporary or permanent work outside the industry or remain unemployed. Consequently, in some circumstances it may not be entirely clear whether an active plan member has ceased to be employed and to accrue benefits in the plan and is, therefore, eligible for early retirement and grow-in benefits.

In sum, I am persuaded for all of these reasons that MEPPs are sufficiently different from SEPPs in regard to the determinants of grow-in benefits and that they should be treated differently.

I have reached the same conclusion with regard to JSPPs, and for some of the same policy reasons. When the parties (a) jointly sponsor and govern a plan, (b) share the risks, and (c) have bargained collectively over early retirement and its consequences — all conditions that apply to JSPPs — there is no need to provide additional protection by way of grow-in rights. Similar considerations would apply to the new JGTBPPs described later in this chapter and recommended in Chapter Eight.

> **Recommendation 5-9** — Multi-employer plans, jointly sponsored plans, and the proposed jointly governed target benefit plans should not be required to provide grow-in benefits.

5.3.6 Flexible retirement

In the previous section I dealt with the controversial issue of grow-in benefits for active plan members who are involuntarily terminated. In this section I deal with the much less controversial issue of active plan members who make a more belated, gradual and consensual transition to retirement. Such workers are often highly valued by their employers; they may work in labour markets characterized by the increasing scarcity of skilled and experienced workers; and they are likely to be in better health than workers of their age used to be. Consequently, they and their employers may have a mutual interest in allowing them to ease into retirement, which might involve their working beyond "normal retirement age" or partially deferring early retirement. Moreover, while recent amendments to the Ontario Human Rights Code outlawing mandatory retirement do not purport to affect the administration of pension legislation or plans, one can foresee that, at some future date, the whole concept of "retirement" as occurring at a fixed or ascertainable point in time may have to be rethought.

Currently, the ITA allows some flexibility for what is called "phased retirement," but the PBA does not. It should.

> **Recommendation 5-10** — The *Pension Benefits Act* should be amended to provide for phased retirement as contemplated by the *Income Tax Act*.

In addition, a study of phased retirement in all its aspects should be undertaken as part of the ongoing development of pension policy that I advocate in Chapter Ten.

5.3.7 Protecting members' interests in the pension fund

In the context of significant changes in the economy and the pension system, active plan members and retirees understandably seek reassurance that interests will continue to be protected, even though the modalities of protection may differ from those with which they are familiar. Three particular issues of special interest in this context emerged from the Commission's hearings and research studies. The first is *vesting*: when do employees acquire rights to pension benefits that cannot be terminated, even though their employment may be? The second is the *disposition of surplus*: if the fund has to be wound up as a result of a change in the corporate structure or business of the sponsor, who will be entitled to what is left over — if anything — once the funds necessary to honour the pension promise have been allocated? And the third is *annuitization*: in what form will funds be earmarked for active plan members when they depart involuntarily from the sponsor's employment and the plan? Each of these issues is dealt with in turn.

Vesting — Pension plans may decline to extend plan membership to employees with fewer than two years' service. Moreover, once employees have become members, their benefits vest under the PBA only after a further two years. Until benefits are fully vested, active plan members are entitled upon leaving the plan only to the return of their own contributions (if any), with interest; thereafter, they are entitled to their accrued pension benefits in full, including that portion attributable to employer contributions. Thus, unless the plan itself truncates one or both of these periods, for up to four years after they are hired employees have at best a tenuous grip on their pension rights.

This renders newly hired employees particularly vulnerable in the event that their employment is terminated due to some corporate transaction that results in the loss of their job. However, the PBA offers them some protection: all pension benefits become fully vested in the event of a wind-up or partial wind-up of the plan. Several stakeholders suggested that this limited protection should be extended so that the pension benefits of new plan members should be fully vested as from the moment they join the plan, and not merely against the consequences of a wind-up but against any event that results in the loss of their jobs and pensions.

Quebec has adopted this approach and it seems reasonable to me, especially in light of my recommendation that pension entitlements — even modest entitlements earned by employees with relatively brief job tenure — can be deposited with the OPA and combined with contributions they have earned elsewhere, so that the whole ends up being something more than the sum of its parts. Of course, such amounts might also continue to find their way to other destinations such as the plan of a subsequent employer or a locked-in RRSP account.

> **Recommendation 5-11** — All active plan members should be immediately vested for all accrued pension benefits. However, as at present, the plan administrator should retain the discretion to authorize the payment out of small amounts in specified circumstances.

Surplus — Current rules require that on full wind-up of a plan, all surpluses must be distributed in accordance with the plan documents and pursuant to specified procedures designed to ensure the sharing of the surplus between the sponsor on the one hand, and active members and retirees on the other. Following the Supreme Court of Canada's *Monsanto* decision (2004), FSCO now requires that on partial wind-up, the portion of surplus related to the employees who are involuntarily terminated must also be distributed.

This latter requirement provoked considerable debate during the Commission hearings. Supporters of *Monsanto* argued that not only did its holding protect entitlements that had been previously ignored, but it also provided benefits to workers confronting the loss of their jobs and future pension expectations in circumstances where replacing either was bound to be very difficult. On the other hand, opponents argued that distribution of surplus from an ongoing plan was both expensive and inequitable. They also expressed frustration with the length of time required for regulatory review of partial wind-ups — a point mentioned earlier in this chapter — due, at least in part, to the complexity of surplus issues introduced by *Monsanto* and its possible retroactive effects. Some proposed that the concept of partial wind-up be deleted from the PBA; others proposed that if the concept is retained, surplus distribution should no longer occur on a partial wind-up.

The arguments for and against *Monsanto* must now be revisited in light of my recommendations in Chapter Four regarding surplus distribution. If those recommendations are accepted, surplus will be distributed on wind-up, either in accordance with the plan documents or, if they are not clear, following negotiations and recourse to a dispute resolution procedure. Furthermore, in the case of ongoing plans, surplus should be used first, to build and maintain a security margin; second, for contribution holidays and the payment of plan expenses, and third — only if it has grown to exceed 125% of required funding — for possible withdrawal by the sponsor pursuant to the same procedures proposed for withdrawal of surplus on wind-up.

These recommendations, in my view, place great emphasis on promoting the health of ongoing plans by laying down two conditions for surplus withdrawal: preservation of a very substantial balance in the plan, and the adjustment of competing claims through negotiation or, if necessary, recourse to a dispute resolution procedure. By contrast, *Monsanto* — whatever the arguments in its favour — envisages an automatic distribution of surplus regardless of the balance in the ongoing plan and without recourse to any such procedure. I am therefore disinclined to the Monsanto approach.

This is not merely a striving for consistency; it is a reaction to the experience of many plans over the past decade that have seen surpluses come and go quite quickly in response to fluctuations in financial markets. This was the rationale for not giving sponsors easy access to surplus, and it is a rationale that applies as well when the contest over surplus pits the terminated members against retirees and ongoing members, neither of whom would — under the proposed surplus rules — have unrestricted access to surplus.

Nor would a modification of the *Monsanto* rule leave involuntarily terminated members with no recourse to the plan assets in their moment of need. As proposed above, I believe that they should be eligible for grow-in benefits. They may also be eligible for plant closure benefits, if any are provided by the plan. And finally, as discussed below, these terminated employees are to be assisted in maintaining the security of their pensions either by remaining as deferred members of the existing plan or by transferring the value of their pensions to the new OPA. If, however, pursuant to *Monsanto*, they also receive a share of the plan surplus, they are being placed in a preferential position relative to continuing plan members and retirees who have no access to surplus except in the limited circumstances noted above.

Finally, restraint in the distribution of plan surplus is not just a matter of fairness as between the terminated members and other plan beneficiaries. Keeping plans in surplus is a way of protecting the Pension Benefits Guarantee Fund (PBGF), which may be called upon to assist if, at some point, the plan has insufficient assets to meet its obligations.

For all of these reasons, it seems inappropriate that a partial wind-up should precipitate a distribution of surplus, as *Monsanto* requires. A better approach, I think, would be to ensure that the terminated members are placed in the same position as they would have been if the partial wind-up had not occurred. That is to say, so long as they are members of the plan, albeit deferred members, they should be eligible to participate in any surplus distribution permitted under my recommendations in Chapter Four on the same basis as if they had remained active members.

> **Recommendation 5-12** — Active plan members who are involuntarily terminated, whether in groups or individually, while a plan is ongoing, should not be entitled to an immediate distribution of surplus. However, those who leave their pension assets in the plan should retain the right to participate in any subsequent surplus distribution.

Annuitization — Finally, several submissions were critical of a recently adopted regulatory requirement that plan administrators must annuitize all members terminated as a result of a partial plan wind-up who elect to remain as deferred plan members rather than transfer the commuted value of their pensions to another plan or to a locked-in investment account. Cost seems to be a primary concern: pension plans shopping for annuities must buy them from an approved Canadian insurance company. The list of approved companies is short and competition is restricted, so prices of annuities are high. Moreover, annuitization may or may not be in the interest of terminating members. If their funds are shifted from the plan to an annuity, they will not benefit from any future growth in its assets because they will be ineligible for any future distribution of surplus under Recommendation 5-12, or for future *ad hoc* indexation or benefit increases. On the other hand, it is certainly true that annuitization enhances the security of their benefit. An annuity is the "pension bird in the hand" for involuntarily terminated employees; they might sensibly prefer it to "two in the bush" plan. However, these employees have other options that might provide comparable security: they may deposit the value of their pensions in the new OPA, where their funds will be invested, will continue to grow and in due course, will yield a pension; or they might deposit them in a locked-in account, which, if conservatively invested, will yield only a modest return but will be relatively safe.

I also addressed the annuities question to some extent in Chapter Four. Given my concerns about the annuities market and the further work to be done on this issue, I am reluctant to accept that the pensions of all members terminated because of a partial wind-up must be annuitized, though annuitization may sometimes be the best answer for all concerned.

> **Recommendation 5-13** — Involuntarily terminated members may have their benefits annuitized at the option of the sponsor.

5.3.8 Definition of "wind-up" and "partial wind-up"

Wind-ups often signal changes in the sponsor's ownership, organization, business fortunes or very existence. They have, therefore, long been identified as a moment for acknowledging the rights of plan sponsors, active members and retirees. For example, wind-ups have triggered entitlement by terminating members to grow-in benefits, annuitization of their accrued benefits, the vesting of the rights of active plan members, and the distribution of surplus. However, recommendations made earlier in this chapter have stripped partial (if not full) wind-ups of most of these dramatic consequences.

Nonetheless, wind-ups remain landmark events in the life of a pension plan. Wind-ups represent the moment when individual entitlements may be crystallized for some — or all — active and retired members and, consequently, when a balance must be struck among their competing claims. And of course, the sponsor is not a mere onlooker. Assessing the state of the plan in order to strike that balance may reveal whether the plan is in surplus or deficit and whether the sponsor can benefit from the former or must make good the latter. Finally, because wind-ups and partial wind-ups are often occasioned by a corporate transaction, the financial state of the plan becomes important to third parties.

However, the PBA does not clearly identify the moment at which a partial wind-up occurs; rather, it gives the Superintendent open-ended discretion to make that decision. No percentage of the workforce or number of workers is specified as a threshold that must be crossed to distinguish a partial wind-up from other, less significant changes in the corporation's structure or activities; nor are partial wind-ups clearly distinguished from full wind-ups.

Many stakeholders, especially SEPP sponsors, argued for greater clarity and precision in the definitions of full and partial wind-up on the ground that they could not predict whether particular transactions would or would not require the Superintendent's approval, and would or would not trigger particular consequences for the plan. Moreover, they said, determining the answers to these questions is time-consuming and expensive. The result is that corporate transactions that might affect the plan are fraught with uncertainty. Nor is this last concern confined to sponsors: active members and retirees also wish to have their rights decided speedily and predictably.

It seems to me that form should follow function: that wind-ups and partial wind-ups should be defined in such a way that these labels are applied in situations when doing so advances the statutory purposes associated with wind-up procedures.

If my recommendations are accepted so that partial wind-ups are shorn of many of their present implications, it seems appropriate to regard them less as a moment when rights are determined than as an occasion to assess the overall state of the truncated plan. For example, when there has been a significant shrinkage of the workforce, the regulator ought to be able to determine that the full wind-up provisions are not being avoided, that payments of commuted values out of a plan reflect its current funded ratio, and that the remaining elements of the plan are viable. If that is their purpose, the threshold for declaring a partial wind-up should be relatively high.

> **Recommendation 5-14** — Partial wind-ups of single employer plans should be declared by the Superintendent only when 40% of the active members of the employer are terminated within a two-year period. In such circumstances, administrators should file a plan reduction report, which would enable the Superintendent to ensure that plan funding is secure.

Full wind-ups present entirely different issues. Determination of the rights of the parties in such an event is unavoidable — and indeed desirable. The only problem is how to recognize a full wind-up when it occurs and to preclude sponsors from avoiding its consequences — including making good any deficiency in funding — by continuing to employ some small part of the workforce and maintaining plan membership for those workers.

> **Recommendation 5-15** — When 90% of the active members of a single employer plan are terminated within a two-year period, the Superintendent should have the power to require that the plan be wound up or reconfigured. This power should be used only if the Superintendent concludes that either (a) the sponsor is not acting bona fide, or (b) the plan in its reduced state is unable to meet its obligations.

Although this happens rarely, MEPPs and JSPPs may also undergo partial wind-ups. In MEPPs, partial wind-ups obviously do not occur when one employer goes out of business or severs its relationship with the union and therefore the plan — or even when several do — since arrivals and departures are an intrinsic feature of any ongoing MEPP. However, since both MEPPs and JSPPs are collectively bargained, the parties may choose to stipulate in advance whether the plan will survive the departure of a significant proportion of either sponsors or active members. In addition, the partial wind-up of a MEPP may occur if there is a split within a union that negotiated the plan, if the dominant sponsor in the plan leaves, or if a significant proportion of employers is affected by a serious downturn in the industry. Such events need not trigger pension entitlements but might sensibly trigger a report on the plan's viability, either on the initiative of the administrator or on orders from the regulator.

Finally, given the change from solvency to going concern funding for MEPPs and JSPPs, recommended in Chapter Four, new benchmarks need to be developed to assess their funded status. These benchmarks should also be used to determine the viability of a plan undergoing a major change in sponsor, union or employee membership.

> **Recommendation 5-16** — If a multi-employer or jointly sponsored pension plan experiences a reduction of 40% of its active members, or of sponsors providing 40% of its contributions, or if the sponsoring union splits, the administrator should prepare a plan reduction report and file it with the regulator. The regulator may require the administrator to prepare such a report if there are reasonable grounds to believe that the plan may no longer be viable.

5.4 The Effect of Corporate Restructuring on Plan Funding and Design

5.4.1 Introduction

When a sponsor sells or divests part of a business and the purchaser hires some of the employees and wishes to maintain continuity in their pension coverage, a pension plan may be split. When a sponsor buys another business and wishes to integrate its pension plan with that of the new business, the two plans may be merged. And when a sponsor sells or buys a part of a business and wishes to arrange that pension assets should follow the active plan members who migrate from one of those businesses to the other, the sponsor may arrange for an asset transfer between the two plans. It is important to facilitate these transactions so long as they are *bona fide* attempts to maintain a plan and continue benefit security. Doing so will help to maintain a favourable environment for DB plans — one of the principles informing this report.

However, splits, mergers and asset transfers seldom meet with unanimous approval. Some oppose them in the context of more far-reaching concerns about the negative effects of corporate restructuring on job security, wages and benefits. Others suspect them as attempts to siphon off plan assets — especially surplus assets — for business purposes. The former concerns will have to be addressed in other forums; they do not fall within my mandate. The latter obviously do, and are addressed in this chapter as well as Chapters Four and Six. However, the fact is that numerous legal objections, court decisions and regulatory interventions in recent years have greatly complicated the treatment of pension transactions. As a result, some of the delays in processing transactions before FSCO can be attributed directly to anticipated or ongoing litigation or the fallout from past litigation.

My objective, then, is to suggest how the pension implications of business transactions can be resolved in a predictable and timely fashion and with due regard for the integrity of pension plans and the rights of plan members and retirees.

5.4.2 Plan splits and mergers

When a plan merges with another plan, or when a plan is split into two or more parts, two outcomes seem to be generally agreed: splits and mergers should not result in liabilities being collected in one plan and assets in another; and changes in benefit structure introduced following a split or merger should have effect prospectively, without prejudice to the accrued benefits of active and retired plan members. The more difficult question is whether, or to what extent, deficits and surpluses can be exported or imported from one plan or part of a plan to another. FSCO policy currently prevents a plan that is at or over full funding from being brought below full funding as a result of a merger or split, and an under-funded plan from having its funded ratio further reduced. The rationale — which I endorse — is that benefits should be no less secure than they were as of the date of the transaction.

Until recently, FSCO had no policy on the redeployment of surpluses following a split or merger, nor does the PBA explicitly address the issue. As a result, sponsors were free to allocate surplus in whichever way facilitated the underlying corporate transaction. However, as a result of recent litigation, FSCO has adopted a policy that restricts the transfer of surpluses whenever the plan in surplus has its origins in a pension trust. Only when the language of the trust clearly permits surpluses to be transferred will FSCO approve a transfer. However, many trust documents are not as clear as they might be, and relatively few contemplate future splits, mergers or other transformations in the configuration of the plan. As a result, sponsors are often denied the opportunity to deploy plan surplus in the way that would most assist them in consummating their corporate arrangements, or for that matter, in the way that would be most beneficial to the newly merged or split plans. In particular, without recourse to court and/or the regulatory processes, sponsors of trust-based plans can no longer integrate a plan somewhat in surplus with one somewhat in deficit to achieve a single, merged plan that is more or less fully funded.

While no doubt most sponsors and some plan members would welcome greater flexibility in dealing with surplus transfers, it is also understandable that members of a plan whose surplus is to be redeployed for the benefit of others might take a different view. The latter view, however, ultimately rests on the assumption that they own the surplus. In Chapter Four I reject that view, along with the view that surplus belongs to sponsors. Instead, I favour a presumption (absent clear contrary language) that surplus must be used to serve the purposes of the plan: to pay for contribution holidays or plan expenses; to be shared between the parties on plan wind-up; in very exceptional circumstances and after complying with specified procedures, to be available for withdrawal while the plan is ongoing; and most importantly, to provide a 5% security margin to buffer the plan against fluctuations in its funded status.

The object of these arrangements is, on the one hand, to ensure that the plan is well-funded and secure, and on the other, to incline sponsors to feel more comfortable with the accumulation of surplus in the plan, thereby contributing to its security over the long term. Applying that same approach to the current issue, I am persuaded that sponsors should be able — within carefully specified limits — to export surplus derived from a previous plan in order to fund a new plan. Putting aside cases where the plan documents forbid the transfer of surplus in specific language rather than by inference from language of general application, I am also persuaded that a standard, non-litigious process for approving such transfers would be an improvement over present arrangements.

> **Recommendation 5-17** — Any surplus in a plan that is to be split (the "original plan") can be allocated to any of the new plans derived from it, provided that the liabilities associated with the original plan and all of the derivative plans remain fully funded (including the 5% security margin) as of the date of completion of the transaction.

Recommendation 5-18 — Any surplus in a plan that is to be merged with another plan can be assigned to the merged plan, provided that the members of the original plan remain in the new merged plan, and that the merged plan itself is fully funded (including the 5% security margin) as of the date of completion of the transaction.

The purpose of these requirements is to ensure that arrangements for the transfer of surplus ultimately protect the interests of plan beneficiaries, rather than improve the financial position of the corporate parties to the transaction. It is therefore important that active plan members and retirees whose pension security is at issue should have an opportunity to learn about and speak to the proposed use of surplus. If they or their union consent, and if there are no other legal impediments, the regulator should be able to provide an advance ruling approving the surplus transfer, as proposed in Chapter Seven. This will facilitate completion of the transaction.

Recommendation 5-19 — A sponsor considering a plan split or merger must give notice of the proposed transaction to active plan members and retirees, and any union or other organization representing them. The notice should be accompanied by an accurate, readily understood explanation of its implications, as well as technical data relating to the new plan in a form approved by the regulator.

If the union or representative organization approves of the proposed transaction or, in the absence of such an organization, if the transaction is approved by two-thirds of the active members and retirees voting in a secret ballot, the approval shall be filed with the regulator. Upon receiving the approval and ensuring that the transaction is otherwise in accordance with Recommendations 5-17 and 5-18, the regulator may, without further delay, issue an advance ruling approving the transaction.

In the absence of approval from the union, organization or plan beneficiaries, the sponsor must give 90 days' notice to all interested parties and to the regulator. After expiry of the 90-day notice, the regulator should process the proposed transaction in the normal manner.

Where a split or merger is proposed by any plan on whose governing body at least 50% of the members are nominated by active plan members and/or retirees, approval by that governing body should serve in lieu of the approval process set out in this recommendation.

I am hopeful that if sponsors are given greater freedom to fund new plans with the surpluses of their original plans, the result might be a somewhat higher plan enrolment overall. Conversely, I am concerned that excessive rigidity with regard to the use of surplus in plan mergers and splits might tempt sponsors to use the occasion of a corporate transaction to discontinue their plans altogether. And finally, I acknowledge that once a new merged or split plan is established, all of its members — including those absorbed from the original plan — are meant to pool their assets and share their risks, and that deviations from this approach are, to an extent, incompatible with the fundamental principles of DB plans.

All of these considerations suggest that the shadow of the original plan ought not to hang over the new plan or plans that result from a split or merger. On the other hand, I am extremely reluctant to propose any arrangements that might move some active plan members and retirees from a position of security to one of insecurity, even though the result might be to facilitate the transaction. The reconciliation of these conflicting concerns becomes extremely difficult in borderline situations where a little flexibility might produce positive results with relatively modest risk. The following recommendation represents my best effort at such reconciliation.

> **Recommendation 5-20** — Notwithstanding Recommendations 5-18 and 5-19, a sponsor may, with the consent of the Superintendent, use surplus from the original plan to fund a new plan into which it has been merged, or from which it is derived, provided that (a) if the original plan continues in force, its security margin is maintained; (b) the new plan is funded at not less than 100% from its inception by sponsor contributions, if necessary; and (c) the security margin in the new plan is funded within five years.

Recommendations 5-17 to 5-20 do not address a situation in which the original plan is under-funded. Under present rules, the result of a split or merger must be that such a plan should not be worse off after the transaction than it was before. This seems sensible to me, and I recommend no change in this regard.

5.4.3 Plan conversions

In Chapter Three I noted a modest shift in pension coverage in Ontario — far less than in the United Kingdom or the United States — away from DB plans and in favour of defined contribution (DC) plans. In Chapter Nine I propose a strategy of promoting innovation in plan design that, to my mind, offers the best prospects for expanding overall pension coverage in tandem with high-quality pensions. An important feature of that strategy is the introduction of new models of plan design, some of which involve a combination of elements of DB and DC plans.

Inevitably, innovation involves not only the creation of entirely new plan models, but conversion of existing plans to new designs. In fact, the process of converting existing plans is already well under way, though not necessarily with a view to promoting broader pension coverage or enhanced pension quality. A number of DB plans have been converted to DC plans or hybrid plans, and more conversions are predicted. These conversions may be attributable to changing member preferences or, more likely, to the desire of sponsors to reduce the volatility and costs ascribed to DB pensions. They may be triggered by a reassessment of the sponsor's pension arrangements, by a general corporate reorganization, or by the sale of a business to a new owner with less commitment to the existing DB plan. Of course, plans that are the result of collective bargaining agreements may convert only if and when the union agrees.

Whatever the occasion or motivation, under current rules, a DB plan may be converted to a conventional DC plan or to a hybrid plan. Hybrids may take many forms: existing members continue to accrue DB benefits while new members accrue DC benefits; DB accruals may terminate for all employees and all future accruals take the form of DC benefits; or both DB and DC benefits may accrue simultaneously with, say, a DB base benefit topped up with DC benefits. Any of these combinations are permissible at present, and the range of options may be extended further, if my recommendations in Chapter Nine are accepted.

Now the controversial point: in some conversions, sponsors seek to use surplus from the original DB plan to make the transition to a DC or hybrid plan, typically by using the surplus to fund a contribution holiday. The recent *Kerry* decision (now on appeal to the Supreme Court of Canada) held that this use of surplus is permissible under Ontario law.

The financial appeal of such an outcome to sponsors is obvious, and it has been defended by them as offering an incentive to continue to provide some kind of plan — albeit with a different benefit structure — rather than no plan at all. And some plan members doubtless favour conversions as well, given that they can usually exercise greater control over their pension assets under DC than under DB plans. On the other hand, the use of DB surplus to fund a conversion to a DC plan has also been characterized as subsidizing the trend away from DB plans, contrary to the policy favouring such plans expressed in my mandate. From this perspective, the more obstacles to conversion, the less likely conversions are to occur. Preventing the use of surplus would be one such obstacle.

In the end, however, my conclusions on this matter are influenced more by my previous analysis of surplus use than by a debate over the relative merits of DB, DC and various hybrid designs. The first claim on the use of surplus, in my view, ought to be to maintain the security of earned entitlements. Since the new DB funding rules (see Recommendation 4-15) require the provision of a security margin of 5% over full funding, it follows that the same margin should be maintained both for DB accruals under the old plan and for further DB accruals, if any, under the new, converted plan. As outlined in Chapter Four, surplus remaining after the security margin is provided should be available for the purposes of the plan.

> **Recommendation 5-21** — Following conversion from a defined benefit to a defined contribution plan, or to a hybrid plan with elements of both, surplus carried over from the original plan should first be used to provide the required security margin for defined benefits earned under either plan. If additional surplus remains, it should be available to fund contribution holidays or other expenses of the converted plan.

Conversions are complex transactions and may lead to a significant change in the pension entitlements of members of the original DB plan. Where the plan is embedded or originates in a collective agreement, the union's consent to conversion is required as a matter of labour law. When the fate of the plan is wholly within the control of the sponsor, detailed communication with plan members concerning the implications of a conversion is highly desirable and, indeed, usually undertaken by sponsors as a matter of good practice. It would be a positive step, I believe, if this practice were made mandatory.

> **Recommendation 5-22** — A sponsor considering the conversion of a defined benefit plan to a defined contribution or other type of plan must give notice of the proposed conversion to active and retired plan members and to any union or other organization representing them. The notice should be accompanied by an accurate, readily understood explanation of its implications, as well as technical data relating to the new plan in a form approved by the regulator.

If the union or representative organization approves of the proposed conversion or, in the absence of such an organization, if the conversion is approved by two-thirds of the active members and retirees voting in a secret ballot, the approval shall be filed with the regulator. Upon receiving the approval and ensuring that the transaction is otherwise in accordance with Recommendation 5-21, the regulator may, without further delay, issue an advance ruling approving the conversion.

In the absence of approval from the union, organization or plan beneficiaries, the sponsor must give 90 days' notice to all interested parties and to the regulator. After expiry of the 90-day notice, the regulator should process the proposed transaction in the normal manner

Where a split or merger is proposed by any plan on whose governing body at least 50% of the members are nominated by active plan members and/or retirees, approval by that governing body should serve in lieu of the approval process set out in this recommendation.

5.4.4 Pension transactions involving closely related corporate entities

Some stakeholders have expressed concerns that corporate transactions resulting in the reconfiguration of pension plans and the use of plan assets may be motivated by a desire to siphon off plan assets. Such concerns are no doubt heightened when the corporations involved are closely related — subsidiaries of a common parent company, for example — or corporations that own each others' shares or have common directors or management personnel. And they are heightened still more when those corporate entities do not enjoy comparable financial health. These concerns are not limited to plan members and their union representatives. For example, the United Kingdom has recently conferred powers on its pension regulator to determine whether a plan is being transferred from a sponsor of substance to one that is effectively a shell with few assets — and in appropriate cases, to reverse such transactions.

Corporations have many legitimate reasons for carrying on their business through a number of different entities, and for coordinating the activities of these entities through a web of common shareholdings, directors and managers. Indeed, this is a commonplace corporate strategy in Ontario and other advanced economies. If public policy is to accept and support the transactions that execute this strategy, however, it is important that public confidence in the integrity of the transactions be maintained. The discovery that the security of a pension plan had been intentionally compromised in the course of such transactions to the financial advantage of the sponsor or the members of its corporate family would undermine that confidence.

Consequently, I am persuaded of the desirability of providing Ontario's pension regulator with powers analogous to those enjoyed by the U.K. regulator. The powers should relate only to transactions between non-arm's-length corporations, which are particularly vulnerable to attempts to isolate the pension plan from corporate assets, and should be carefully designed so as to interfere as little as possible with what have been, up to now, matters wholly within the sponsor's discretion. Other sections of this report recommend that the Superintendent develop methods to assess the status of sponsors and whether that status may put plans at risk of failure. As those methods develop, it may be appropriate to use them, as well, to provide information on transactions such as plan mergers and splits — even in relation to arm's-length transactions. In the meantime, it should be open to active members, retirees and representative organizations to make submissions as to how a change in corporate sponsorship may affect the security of the plan in particular circumstances.

> **Recommendation 5-23** — The regulator should have the power to review the effects of a plan split, merger, asset transfer or other pension transaction involving related corporate entities in order to ensure that the plan's financial prospects have not been compromised by being assigned to a less solvent corporate entity. The regulator's powers should be exercised in accordance with specified criteria, and should include the power to (a) require a plan to be brought up to its previous funding level, or 105% of full funding, whichever is the lesser, (b) require the previous sponsor to provide guarantees that the new sponsor will meet its obligations to the plan, and (c) rescind the transaction.

CHAPTER SIX – WHEN PLANS FAIL

6.1 Introduction

Pension plan failures involve consequences that may be both dire and diffuse. Retirees, who depend to a considerable extent on their occupational pensions, are likely to experience an immediate decline in their standard of living with little possibility of finding new jobs to recoup their position. Active plan members confront not only the future loss of their promised pension benefits, but also — because plan failure generally coincides with the insolvency of the sponsor —the immediate loss of their job and the wages and non-pension benefits on which they and their families depend. Local communities in which workers and retirees live — especially "one industry" towns — may suffer a serious economic and social crisis. Governments may have to support retirees who become eligible for needs-related assistance programs as a result of losing their occupational pensions. And taxpayers may not only have to fund those programs but make up shortfalls in tax revenue caused by the fact that retirees pay less taxes on their depleted or discontinued pensions.

Given these sometimes dramatic consequences of plan failures, it seems clear to me that the first priority should be to anticipate and forestall them whenever possible. Of course, notwithstanding prophylactic measures, some plan failures will inevitably occur because the sponsoring employer becomes insolvent. A second priority should therefore be to ensure that a pension plan, its active members and its beneficiaries are dealt with fairly in the context of the sponsor's insolvency proceedings. However, even if they are, serious financial distress will still befall individuals who did not cause the problem and could neither anticipate it, nor insure themselves against it nor recover from it. Mitigation of their distress and of its social consequences should therefore be a third priority for pension law and policy.

6.2 Enhanced Vigilance

There is an unavoidable interplay between the funding health of the plan and the financial health of the plan sponsor. In effect, plans fail when the sponsor fails.

That is why pension legislation requires not only that sponsors pre-fund their plans at levels adequate to meet their liabilities, but that plan assets be legally segregated and unavailable to sponsors or their creditors. Of course, absolute security against plan failure — "full funding all the time," favoured by some unions and workers at our hearings — comes at a cost. If the cost is too high, sponsors may be unable or unwilling to continue to support the plan and their creditors may force them to close the plan before insolvency, or may siphon off monies owing to it afterward.

This balance between absolute security and the costs of achieving it is perceived differently by single-employer pension plan (SEPP) participants on the one hand, and multi-employer pension plan (MEPP) and jointly sponsored pension plan (JSPP) participants on the other. Indeed, the balance is often struck at the inception of a SEPP when the choice is made between flat or career average benefit plans on the one hand, and final average benefit plans on the other. The former seem to fail more frequently than the latter and to maintain noticeably lower funded ratios, perhaps because improvements in benefits for past service are not required to be funded immediately. However, regardless of plan design, SEPP sponsors are ultimately obliged to make good all deficiencies. This obligation persists whether a plan is in difficulty but ongoing, or being wound up. In practice, though, if the sponsor is in difficulty, its creditors can almost always claim its corporate assets in priority to claims by the pension plan. In these circumstances, deficiencies are not made good, plans fail and claims are made on the Pension Benefits Guarantee Fund (PBGF).

MEPP and JSPP sponsors must meet their funding obligations as well, but if they fail to do so they have other options. In the case of JSPPs, active plan members as well as sponsors may be called on to increase their contributions in order to make good any shortfall in the funding of ongoing plans. In the case of MEPPs, benefits may be reduced if assets in an ongoing plan are inadequate to pay them. In the case of both MEPPs and JSPPs, benefits may also be reduced in the event of a deficiency when the plan is being wound up. Finally, neither MEPPs nor JSPPs pay into or are "insured" by the PBGF. These different responses of SEPPs, MEPPs and JSPPs to insolvency must not only be reflected in the law — they must be made clear to all beneficiaries from the outset of the plan.

Avoiding plan failure has been a recurring motif of this report. In Chapter Four I made recommendations concerning more accurate and transparent valuations and more stringent funding requirements in the form of a security margin, and in Chapter Nine I recommend the consolidation of small SEPPs into larger units. These recommendations should assist in improving the financial health of pension plans. In addition, recommendations in Chapter Four for enhanced monitoring and interim valuations for faltering plans, and in Chapters Seven and Eight for more effective regulation and more transparent governance, should help to expose problems while they can still be fixed, and thereby reduce the risk that plans will fail if the sponsor fails.

Whatever structural improvements can be made in the funding of plans, however, some are always likely to be in difficulty. The regulator should be poised to intervene in timely fashion.

> **Recommendation 6-1** — The Superintendent should have the power to establish benchmarks that identify plans "at risk of failure;" to order additional valuations and reports by such plans, if the benchmarks are met; and to require such valuations and reports to be conducted or reviewed by independent auditors and actuaries, or by auditors, actuaries or other staff of the pension regulator, at the cost of the sponsor.

To complement my other recommendations, I now recommend two changes that will encourage the parties to seek, and will empower the regulator to approve, consensual arrangements designed to restore the stability of plans and prevent failures. Such arrangements are not presently contemplated by Ontario's *Pension Benefits Act* (PBA), a fact that has prompted *ad hoc* legislative intervention in previous, high-profile situations. It would be better to confront the possible need to reset the plan, or to implement other sensible compromises, with strict oversight by the Superintendent, so that solutions are available for small and large plans, and so that experience can inform the development of new regulations or practices, if they are needed.

> **Recommendation 6-2** — The Superintendent should have the power to (a) approve arrangements to reset the funding obligations of single-employer plans at risk of failure, including contributions, payment schedules, amortization periods and premiums to be paid to the Pension Benefits Guarantee Fund, and (b) authorize the provision of additional forms of security, to ensure that the plan does not fail and/or that the interests of plan members are better protected in the event that failure does occur. The Superintendent may exercise this power notwithstanding the provisions of plan documents.

Arrangements submitted to the Superintendent for approval must be agreed to by the plan sponsor and by a union or other organization authorized to represent active plan members and retirees. In the absence of a union or other authorized organization, the arrangements must be approved by a two-thirds majority of active and retired plan members voting by secret ballot. In the event that the arrangements affect Pension Benefits Guarantee Fund premiums or coverage, the administrator of that Fund must also approve.

Recommendation 6-3 — The Superintendent should have the power to initiate, facilitate and approve arrangements relating to all aspects of multi-employer plans at risk of failure or of significant benefit reduction. The Superintendent may exercise this power notwithstanding the provisions of plan documents.

Arrangements submitted to the Superintendent for approval must be agreed to by the plan sponsors and by a union or other organization authorized to represent active plan members and retirees. In the absence of a union or other authorized organization, the arrangements must be approved by a two-thirds majority of active and retired plan members voting by secret ballot.

During the Commission's hearings, several submissions made the point that some plans were placed at risk — or enhanced risk — because sponsors and unions agreed to initiate benefit improvements at a time when funding was inadequate to support such improvements. Often these improvements tilt the balance of funding toward those who have negotiated them, sometimes to the detriment of retirees and, not infrequently, with extreme prejudice to the plan itself. I seriously considered recommending that benefit improvements under such circumstances should be forbidden. However, I have become convinced that there are circumstances under which such improvements can be justified, and that a total ban may be too draconian a step. Consequently, I am making two more modest recommendations:

Recommendation 6-4 — When a pension plan has been identified as "at risk," the Superintendent should have power to approve the arrangements identified in Recommendations 6-2 and 6-3, conditional upon the suspension or cancellation of any agreement to improve plan benefits, and/or a prohibition on plan benefit improvements, until funding is restored to a specified level.

Recommendation 6-5 — When a plan fails and is being wound up, payments attributable to benefit improvements initiated up to five years prior to the date of the wind-up should be paid only after all pre-existing benefits are paid in full.

Further, plan administrators have the right under the PBA to sue to recover unpaid contributions. If they decline to do so, the Superintendent has the power "to require an administrator … to take any action … in respect of a pension plan" — presumably including litigation. The Superintendent also has the power to prosecute "every director, officer, official or agent" of a sponsor corporation for contravening the PBA, and to ask the court upon conviction not only to impose a sizeable fine, but to "assess the amount not submitted or not paid" and to order that person to pay the unpaid contributions to the pension fund. In addition, I recommend in Chapter Seven that both the Superintendent and the new Pension Tribunal of Ontario (PTO) should be provided with plenary powers to remedy all violations of the PBA and the regulations. Thus, it should now be possible to put into operation the principle of graduated regulatory responses outlined in Chapter One.

However, effective regulation depends not simply on having powers, but also on using them and being seen to do so. At the moment, the Superintendent relies heavily on informal strategies to deal with delinquent sponsors that have failed to pay their contributions, relatively rarely on prosecution, and seldom on other legal enforcement strategies. While this informal approach does achieve the desired results in most cases, it has two shortcomings. First, those who have violated the PBA and, in some cases, imperilled a pension plan, end up simply doing what they ought to have done in the first place — at no additional cost to themselves, except, perhaps, having to pay interest on overdue remittances. Second, informal disposition does not generate a demonstration effect that might deter other potential wrongdoers. While I certainly do not favour the gratuitous use of remedial or punitive powers, I do think that the regulator ought to adopt a more comprehensive and proactive approach to compliance. The integrity of individual plans, and of the system as a whole, depends if not on total compliance, then as near to it as practicable.

> **Recommendation 6-6** — The regulator should create an office of compliance to deal with the failure of sponsors to remit contributions and other violations of the *Pension Benefits Act* that imperil the security of pension plans and impede regulatory oversight of the pension system. That office should also maintain, for its own purposes and for the benefit of interested parties, an on-line register of delinquent sponsors and other offenders, and the measures taken to deal with them.

None of the recommendations in this section deals directly with a situation where the sponsor of a SEPP is insolvent or bankrupt. Such situations must, of course, be dealt with under federal bankruptcy and insolvency statutes, which, however, do not apply to pension plans *per se*. In the next section of this chapter, I address the interface between these federal statutes and provincial pension law.

6.3 Fair Treatment of Pension Plans and Beneficiaries in the Event of Sponsor Bankruptcy or Insolvency

6.3.1 Introduction

As I indicated in Chapter One, an important principle shaping this report is the desirability of better coordination among public policies that affect the pension system. The disjuncture between provincial pension law and federal bankruptcy and insolvency law is a prime example of the need for improved coordination.

6.3.2 The protection of pension funds under federal insolvency legislation

Under the federal *Companies' Creditors Arrangement Act* (CCAA), companies with debts greater than $5 million are permitted to seek court protection — in effect, a temporary suspension of their obligation to pay their debts — pending approval of a restructuring plan by creditors and/or the supervising court. Restructuring typically involves permanent forgiveness by creditors of some or all of the debt. Arrears of pension plan contributions are treated like any other debt. But while future accruals may be dealt with in the CCAA process, the reduction of accrued benefits may not. That said, active plan members may be willing to surrender some of their rights in order to retain their jobs and keep the company afloat and the plan in force.

If the CCAA process succeeds, the corporation's debt is restructured; it is discharged from court protection; and it remains a going concern. In these circumstances, it will pay its pension contribution arrears according to regulatory requirements and its other debts under whatever terms are agreed upon or ordered. Moreover, its obligation to pay future contributions will be revived on the original basis, unless the plan has been cancelled by the sponsor, or a reduction in its future terms has been consented to by the active and retired members (usually under pressure) or ordered by the court.

If a company does not qualify for CCAA proceedings, or if those proceedings do not result in successful restructuring, the federal *Bankruptcy and Insolvency Act* (BIA) comes into play. The BIA also permits restructuring, but if this fails, the insolvent firm is wound up and its assets are distributed among its creditors. Secured creditors must be paid in full before unsecured creditors are eligible to receive payment. If insufficient funds are available to pay them in full, unsecured creditors are paid on a *pro rata* basis. Crucially, debts owed to a pension fund have up to now been classed as unsecured and therefore, as a practical matter, have often been unrecoverable. However, the new federal *Wage Earner Protection Program Act* — recently proclaimed in force — will accord pension funds a degree of protection somewhat more consistent with their importance under provincial legislation. Under this new legislation, the "normal cost" of plans — that is, arrears of current contributions as defined by federal regulations — is to be accorded priority over other claims under the BIA, although unfunded liabilities and solvency deficiencies are not.

While it improves the position of pension plans, their active members and retirees, this legislation does not fully respond to arguments made by some in favour of giving higher preference to pension claims in bankruptcy and insolvency proceedings.

The extent to which pension plans and their active and retired members ought to be protected against the consequences of sponsor insolvency is a matter of considerable debate. On the one hand, while employees trade current wages for the promise of future pension income, they may not understand that this arrangement entails the risk that the sponsor may become insolvent or bankrupt. On the other, employees in given circumstances may indeed understand the risk but tacitly or explicitly accept it in order to keep the sponsor in business and avoid cancellation of the plan. Moreover, giving pension liabilities a higher priority in restructuring and insolvency proceedings would likely create private market pressures for better funding of pension plans. While no bad thing in itself, however, this pressure might have a detrimental effect on the employer's ability to raise capital, stay in business, provide jobs and fund the pension plan; indeed, it might result in lenders and investors more aggressively resisting the establishment or maintenance of pension plans, even if insolvency is not immediately a prospect.

The debate raises complex issues, most of which, however, must ultimately be resolved by federal, not provincial, legislators.

> **Recommendation 6-7** — The government of Ontario should support recent federal legislation that gives priority to unpaid current pension service costs in the event of bankruptcy. It should also initiate discussions with the federal government concerning the possibility of extending similar priority to all special payments to fund both solvency deficiencies and unfunded liabilities owing to the plan by the sponsor at the time of insolvency.

The recent federal legislation also provides that in the event an arrangement involving the priority claims of a pension plan is reached with the insolvent's creditors, any change in the priority for current service costs will be approved by a court only if the Superintendent has approved the arrangement.

> **Recommendation 6-8** — The *Pension Benefits Act* should be amended to permit the Superintendent to approve arrangements and changes in arrangements that involve the claims of pension plans under federal bankruptcy legislation.

One submission to the Commission from a law firm that represents active and retired plan members proposed that Ontario could take steps under provincial law to treat all unpaid contributions as subject to a trust in favour of the plan and its beneficiaries. Indeed, the PBA deems current contributions to be held in trust for the fund, and subjects the sponsor's assets to a lien and charge in favour of the plan administrator until payment is actually made. In principle, these provisions — or some revised version of them — might be construed as excluding those assets from the sponsor's estate and making them unavailable to other creditors in insolvency proceedings. However, provisions of the BIA appear to nullify or take precedence over the PBA provisions. Quite apart from the merits, unless and until this apparent constitutional impasse is resolved, it would be futile for me to recommend further changes to the PBA that are designed to create trusts or liens to withdraw unpaid contributions from the sponsor's estate, and to provide pension plans with enhanced protection in the event of bankruptcy or insolvency. While I am therefore not prepared to make a formal recommendation concerning this issue, I do urge that this question be studied by the province's law officers.

Finally, even though the province cannot alter the priorities established by federal law among creditors of the insolvent sponsor's estate, there is no reason why it cannot determine how a depleted pension plan apportions losses among its active and retired members. Current PBA regulations require *pro rata* distribution of the assets of the pension fund in these circumstances. For example, if a plan is 75% funded, then all active members and retirees receive 75% of their promised benefit, whatever it might be. However, it may be that different priorities would encourage more vigilant behaviour on the part of those who are in a position to detect or forestall the sponsor's insolvency, or to protect groups that are particularly vulnerable. For example, in the United Kingdom, retirees' claims are given priority over those of active members, perhaps on the ground that the latter were in a position to negotiate plan changes that may have affected the funded ratio. Plans might also be allowed to establish priorities specific to their own circumstances, although there is a risk that this might disadvantage retirees and others excluded from plan governance. Or, a third approach: recent benefit improvements could be excluded from payment in the event the plan has to be wound up while in deficiency, as they are under the PBGF. This latter approach was supported in several submissions to the Commission, and seems sensible to me.

> **Recommendation 6-9** — Plan assets should be distributed on a pro rata basis. However, benefit improvements introduced within the last five years should be postponed until after other benefits are paid, in accordance with Recommendation 6-5, above.

6.3.3 The representation of pension interests in federal bankruptcy and insolvency proceedings

What priority ought to be given pension funds in the event of the sponsor's insolvency or bankruptcy raises some difficult issues of public policy; whether the interests of pension funds and those of their beneficiaries should be entitled to effective representation in insolvency or bankruptcy proceedings does not. Clearly, as a matter of basic justice, all interested parties ought to have the right to be heard in any contentious proceedings. However, that right does not now clearly exist, and will not exist until certain modest changes have been made to federal bankruptcy legislation.

The task of protecting pension rights and interests might be assigned to the pension regulator; to the pension fund itself, acting through its administrator; or to the plan beneficiaries acting individually or collectively. However, the status of all three in bankruptcy and insolvency proceedings is unclear.

The pension regulator — the Superintendent — is arguably best placed to defend the interests of the pension fund against the other creditors of an insolvent sponsor. The Superintendent knows, or should know, more about the fund's claims than anyone else except the administrator, who is often compromised as being the *alter ego* of the sponsor responsible for deficiencies. The Superintendent also knows more about pension law and the pension system than any other potential litigant, and in defending the fund would be defending the system as well. The Superintendent's authoritative participation on behalf of the plan may reduce or eliminate the possibility that other parties — active and retired members and their representative organizations — will have to intervene on its behalf. And finally, the Superintendent has — or will have, if my recommendations are accepted — the legal and other resources necessary to negotiate and, if needs be, litigate on behalf of the fund. However, only when the Superintendent is subrogated to the rights of a sponsor whose plan members will be compensated by the PBGF, or when concessions under the regulatory regime are sought, does the Superintendent presently have an unchallenged right to appear in insolvency and bankruptcy proceedings.

> **Recommendation 6-10** — The Ontario government should seek to persuade the federal government to amend its bankruptcy and insolvency legislation to give the pension regulator the right to intervene in proceedings under that legislation to defend the interests of any pension fund and its members. Provincial law should allow the pension regulator to act on behalf of, and to assert all the rights and powers of, the plan administrator in the context of bankruptcy and insolvency proceedings, if the regulator believes such action is warranted.

If these changes in federal legislation can be negotiated, the pension regulator's role in proactively defending both pension plans and the PBGF would be reinforced. However, in order to take on these enlarged responsibilities in insolvency-related proceedings, the regulator would have to develop new capacities — the subject of recommendations elsewhere in this report — and to deploy staff dedicated to dealing with potential and actual sponsor insolvencies.

To avoid imposing excessive burdens on the regulator, it would therefore be preferable if plan administrators were able and willing to conduct such litigation on their own behalf. However, there are two potential obstacles to their doing so. The first is the problem of resources. The costs of litigation may be insupportable, especially for small funds already facing financial difficulties because of the sponsor's failure. The second, already referenced, is that many SEPPs are self-administered. When the sponsor is placed in receivership, or taken over by a trustee in bankruptcy, the receiver or trustee steps into the sponsor's shoes and becomes administrator of the pension plan as well. This creates an obvious conflict of interest in that, unlike other creditors, the pension plan does not stand at arm's length from the receiver or trustee whose responsibility is to the insolvent's estate as a whole.

The Superintendent presently has power to appoint or replace plan administrators in the limited circumstances of a plan being wound up. That power should be extended to ensure that the plan is being administered by someone other than the trustee or receiver of an insolvent sponsor.

> **Recommendation 6-11** — The regulator should be specifically empowered to replace the administrator of a plan whose sponsor is involved, or is deemed at risk of being involved, in bankruptcy or insolvency proceedings. The Ontario government should ask the federal government to amend the relevant legislation to ensure that the new administrator so appointed can participate in all proceedings on behalf of the plan.

While some individual beneficiaries and organizations representing them have been allowed to appear in proceedings under the BIA or the CCAA, their right to do so is not explicitly guaranteed by the relevant legislation. However, these individuals and groups are profoundly affected by the outcome of such proceedings and they clearly should have the right to participate — individually or collectively — in order to defend their (sometimes conflicting) rights and interests. Moreover, their participation in proceedings may have the desirable side effect of ensuring that the fate of the pension plan is given more serious consideration in negotiations among creditors leading up to the approval of a restructuring proposal.

Of course, participation without legal representation is likely to be futile, and legal representation will be too expensive for almost all individuals and for many groups. At present, the cost of representing active and retired plan members is sometimes borne by unions, and sometimes by individual employees and retirees who pool their modest funds to engage counsel. However, other adversely affected individuals are often effectively barred from participation for lack of funds. A conventional response to this situation is to permit successful litigants to be awarded costs out of a fund if their intervention has led to its successful defence or enhancement. This seems like a sensible, if partial, solution to the problem.

Broadening the range and increasing the number of participants in insolvency proceedings creates a risk that such proceedings will become unduly protracted. Again, there are conventional responses to this problem: a court may make a representation order so that all those with a common interest are represented by the same counsel, or a class of litigants may apply to be certified in order to pursue a remedy in common. These approaches ought to be considered in any reforms that the federal government might choose to pursue.

Recommendation 6-12 — The Ontario government should explore with the federal government the amendment of relevant federal legislation so as to ensure that pension plans, beneficiaries and organizations representing them can participate as of right in bankruptcy and insolvency proceedings. It should also explore ways to facilitate the collective participation of pension litigants in such proceedings by means of representation orders or otherwise. And it should amend the *Pension Benefits Act* so as to enable courts to order pension plans to reimburse beneficiaries and representative organizations for successfully defending the interests of the plan.

6.4 Mitigating the Effects of Plan Failure: The Pension Benefits Guarantee Fund

6.4.1 Introduction

During the Commission's hearings, worker representatives and scores of individual workers appeared to attest to their painful experiences with plan failures. Because plan failure is almost always the result of sponsor failure, the consequences are compounded for SEPP members. Not only are workers' future pension prospects entangled with the fate of a single plan sponsor; so, too, are their current and future prospects for wages and non-pension benefits. So, too, are the pensions of retirees who have depended on the now-insolvent sponsor not only for a monthly pension cheque, but often for extended health care and drug coverage. So, too, are the prospects for whole communities in which that same sponsor has been a major taxpayer, employer, purchaser of goods and services and civic benefactor.

There are therefore strong moral and political pressures on governments to adopt measures to mitigate the effects of plan failure. In Ontario, these pressures resulted in the creation of the PBGF in 1980. The PBGF ensures that in the event of plan failure, retirees will receive compensation sufficient to bring their pension benefits (subject to some exclusions) up to a maximum of $1,000 per month. The PBGF is funded by a levy on plan sponsors based on a per capita premium of $1 per year plus a risk premium that varies according to the level at which the plan is funded — the higher the level of funding, the lower this portion of the premium — to an annual maximum of $4 million. The PBGF benefit formula has not changed since its inception in 1980, while the premium rates were last revised in 1992.

Not all plans are covered by the PBGF. Plans that have been in existence for fewer than three years are ineligible. Plans established under collective agreements that fix employer contributions at an agreed sum are not covered. Plans in the core public service, and to some extent in the broader public sector, are exempt, presumably on the grounds that they are unlikely to fail or, seen in another light, are backstopped by their sponsor's assets — and ultimately by Ontario's taxpayers. MEPPs and JSPPs are not covered, presumably because they are designed so that deficiencies on winding up are dealt with by adjusting benefits downward. And finally, under ill-advised regulations adopted in 1992 to assist Ontario's major private sector employers, plans deemed "too big to fail" were permitted to elect to be relieved of solvency funding requirements in exchange for paying additional PBGF premiums to a maximum of $5 million per plan (instead of the standard premium maximum of $4 million). Of the relatively small number of plans for which such an election occurred, most have, in fact, come close to failure, sometimes with significant adverse consequences for the PBGF. No new elections are permitted, and properly so.

6.4.2 The case for and against the Pension Benefits Guarantee Fund

The PBGF has been the subject of considerable criticism. One common allegation is that knowing that the benefits are protected by the PBGF, hard-pressed sponsors may be tempted to under-fund their plans, and unions to acquiesce in the risks associated with under-funding, so that money otherwise earmarked for pension contributions can be diverted to business investments or to improving other aspects of the compensation package. The PBGF, in this analysis, creates what is called a "moral hazard" — an inducement to engage in overly risky behaviour because the normal risks associated with that behaviour are mitigated. Some support for this position is found in a study undertaken for the Commission by Norma Nielson, who found that Ontario plans are funded at a lower level — $17,037 per capita less — than plans in other provinces that do not have guarantee funds, although she stops short of demonstrating a causal relationship between the PBGF and lower funding levels.

It must be said that if, indeed, the PBGF represents a moral hazard, it is a rather inefficient one in the sense that it has tempted relatively few employers or unions — at least to the point where they ran risks that led to failure. In fact, for the first 20 or so years of its existence, the PBGF dealt on average with about three plan failures per year. And in almost every case, the problem has not been simply under-funding of the plan, but the failure of the sponsor's business — in part, perhaps, because Ontario's funding rules are relatively rigorous, and in part because the PBGF disallows payment of benefit improvements that were agreed to up to three years prior to failure. However, plan failures since 2003 have become much more frequent, especially in the province's declining steel and auto sectors.

Second, some sponsors have complained that their well-funded plans were obliged to pay PBGF premiums that effectively subsidized employers — including their competitors — by allowing them to continue their plans at lower cost. While there is some justice in this complaint, PBGF premiums are already partially risk-rated so that sponsors that under-fund their plans must to some extent pay for the privilege of doing so. More sophisticated risk-rating would seem to be the proper response to this concern so long as the PBGF remains in force.

Third, for some the PBGF represents a "belt and suspenders" approach to the risks of plan failure — a redundant form of protection. Workers, they note, are shielded twice from the full impact of the failure of an under-funded plan — once by the PBGF, and a second time by the broader Canadian social security systems comprising the Old Age Security (OAS) payment (which includes the Guaranteed Income Supplement, or GIS), the Canada/Quebec Pension Plan (C/QPP) and the Ontario Guaranteed Annual Income Supplement (GAINS). Seen in this light, one of the biggest beneficiaries of the existence of the PBGF may be the OAS/GIS and GAINS programs, which are spared the obligation of supporting beneficiaries who have lost their pensions but have been compensated by the PBGF.

Finally, comparisons with guarantee funds in other jurisdictions may shed some light on the question of whether Ontario's PBGF should continue. No other Canadian jurisdiction has such a fund. The United Kingdom and the United States do, but the latter's guarantee fund in particular is in considerable difficulty. Germany, Sweden, Switzerland and Japan also have guarantee funds of varying designs — but all operate pension systems with fundamentally different funding rules. And Finland and the Netherlands, among other European countries, operate successful workplace pension systems without a guarantee fund at all but with very stringent funding requirements. These examples suggest that the existence and the design of a guarantee fund both depend heavily on plan funding requirements. The more rigorous the requirements, the less need there is for a guarantee fund. If that is the lesson to be learned from comparative analysis, I would have to confess that I detected no enthusiasm among Ontario sponsors for replacing the PBGF with a requirement for significantly enhanced funding security and the increased costs they would have to incur to provide it.

Likewise, if the claims of pension funds enjoyed full and pre-emptive priority under federal bankruptcy and insolvency laws, there would be less need for the PBGF. But again I detected no enthusiasm for such an approach (which, in any event, would have to be adopted by the federal government, not Ontario).

For sponsors, then, the PBGF can be seen as a relatively low-cost response to the potential risks of plan failure. Indeed, FSCO data shows that 98% of all plans pay annual PBGF premiums lower than $100,000 per year; that no plans are affected by the normal premium cap of $4 million; and that only two plans are affected by the special contribution cap of $5 million imposed by the 1992 "too big to fail" regulation. For 96% of all defined benefit (DB) plan sponsors, PBGF premiums represent less than 5% of the annual solvency cost of the plan.

On the other hand, active members, retirees and unions criticized the PBGF from quite a different perspective. The problem, in their view, was that the PBGF fails to provide adequate protection for workers. As they correctly note, to simply honour the spirit of the 1980 legislative determination that retirees in failed plans should be eligible for PBGF coverage up to $1,000 of pension benefits per month, the eligibility limit would have to be raised to about $2,500 per month in today's dollars. They favoured raising contribution levels and, if necessary, the contribution cap.

Some of those who favoured raising benefit limits under the PBGF also favoured — or at least did not disfavour — supporting the Fund with government subsidies, if required, to ensure adequate levels of protection. If, as suggested earlier, the greatest beneficiaries of the PBGF have been government support programs for seniors, this position may have something to recommend it. However, it is hard to make the case that the loss of privately provided pensions should be compensated at public expense when holders of life and casualty insurance policies, bank deposits and trust company investment certificates must look to an industry-sponsored fund. It is equally difficult to argue that the majority of taxpayers who have no occupational pension coverage at all should subsidize the minority who do.

In fact, the exact relationship of the government to the PBGF is somewhat ambiguous. When it was confronted in 2001 with potentially devastating claims as a result of the insolvency of Algoma Steel and the possible failure of Algoma's pension plan, the government made a loan of $330 million to the PBGF to keep it solvent. While that loan is being slowly paid down, it is not clear that the government could or would stand behind the PBGF in the event that aggregate claims were to significantly exceed its assets in the future. Indeed, if the government did not come to the rescue, it is difficult to see how such a situation would be resolved under the law as it presently stands. The PBA does not specify how the PBGF should deal with its own impending insolvency. Should it pay all pending claims on a *pro rata* basis? Or pay those who were first in the queue? Or impose a special emergency levy on all plans to restore its solvency?

These questions may turn out to be moot. After all, putting aside three very large plan failures (which among them accounted for almost 70% of all claims to date), the PBGF has pretty much managed to pay its way during its first 30 years. On the other hand, we should be wary of extrapolating from past experience. Both the volume and value of claims has accelerated sharply over the past five years, during which 89% of all PBGF payouts have been made. At the very least, if the PBGF continues for now — as recommended below — clear provision must be made to deal with a possible "shipwreck" scenario.

> **Recommendation 6-13** — The Pension Benefits Guarantee Fund should be continued in its present form, but with the improvements proposed in Recommendations 6-14 to 6-17 for at least five years or until completion of the review proposed in Recommendation 6-18, whichever is later. On the basis of the findings of that review, the government should determine whether to continue, amend, replace or discontinue the PBGF.

6.4.3 Improving the Pension Benefits Guarantee Fund

The Organisation for Economic and Co-operative Development (OECD) has promulgated principles for the guidance of those responsible for pension guarantee funds:

- Benefit coverage should be limited so that potential beneficiaries share some of the risk.
- Pricing or levies should be risk-based.
- The guarantee fund should have in place accurate and consistent funding rules and should operate under prudent asset–liability management.
- The system must have adequate powers to avoid moral hazard.

I believe that adherence to these principles would assist Ontario in achieving an economically efficient and financially viable guarantee system.

Who should be responsible for ensuring that these principles are adhered to? There is some logic to integrating the PBGF's management with that of FSCO, as at present. For example, risk assessment may be useful for both insurance and for regulatory intervention; the avoidance of moral hazard — if it exists — potentially gives rise to both insurance and regulatory implications. However, it is somewhat anomalous to vest both regulatory and insurance functions in a single official or agency, especially given that there is no evidence that the Superintendent has been consciously promoting synergy between them. On balance, I believe that a different approach to management of the PBGF should be tried.

The guarantee funds in the United States and the United Kingdom operate at arm's length from the pension regulator — a model that would enable the PBGF administrator to assume the enlarged responsibilities recommended below. However, given that the regulator and the PBGF must operate within a common regulatory framework, it is important that their efforts be coordinated and mutually reinforcing. In the United Kingdom this coordination is achieved by mandating the Pension Regulator to protect the Pension Protection Fund, an approach that has much to recommend it. Its corollary, the obligation of the PBGF to contribute to effective regulation, should likewise be acknowledged.

Recommendation 6-14 — The Pension Benefits Guarantee Fund should be administered, preferably at arm's length from the pension regulator, by an agency with a mandate to:

- manage the Fund so as to enhance its capacity to evaluate the individual and collective risks of plans whose performance is guaranteed by the Fund;
- fix levies, subject to the approval of the Minister, in amounts sufficient to meet claims arising from those risks;
- collect such levies and hold and invest them on behalf of the Fund; and
- undertake systemic analysis to assist the regulator in reducing the number and aggregate value of claims on the Fund.

The regulator's mandate should be extended to include protection of the Pension Benefits Guarantee Fund, and the mandate of the Fund should include specific reference to its obligation to assist the regulator.

In Recommendation 6-5, I proposed that payment of unfunded benefits agreed within five years prior to the sponsor's insolvency be postponed until all other benefits under the plan are satisfied. To be consistent with this recommendation, and in response to admonitions about the need to avoid moral hazards, I believe that payment of benefits out of the PBGF should be subject to a similar disqualification.

Recommendation 6-15 — Benefit improvements agreed to within five years prior to the failure of a plan should be ineligible for payment out of the Pension Benefits Guarantee Fund.

The OECD recommends that PBGF levies should be risk-based. This reflects present practice, to some extent. However, I believe that risk assessment can be made much more sophisticated than it now is. For example, in the United Kingdom, the risk assessment on which levies are calculated includes an evaluation of the sponsor's viability, as well as that of the pension plan itself. Given the close causal connection between the two, this seems highly appropriate.

Recommendation 6-16 — The risk assessment protocol by which levies are established for the Pension Benefits Guarantee Fund should be studied and revised to include not only the funding status of plans but other risk-generating factors such as the asset/liability match within the plan and the sponsor's financial health.

Despite — or because of — my recommendations to reinforce the administration and funding of the PBGF, I believe that a strong case has been made for restoring the level of guarantees originally provided by the PBGF to their equivalent in current dollars. At present, they are much lower than those provided by counterpart guarantee funds in the United Kingdom and the United States. However, benefits cannot be increased without a full appreciation of the cost of doing so, of how that cost should be distributed among plans covered by the PBGF, and of the effects of an increase on other aspects of the pension system.

Recommendation 6-17 — The level of monthly pension benefits eligible for protection by the Pension Benefits Guarantee Fund should be increased to a maximum of $2,500 to reflect the effect of inflation on the original maximum of $1,000.

The Superintendent (or other agency responsible for the administration of the Pension Benefits Guarantee Fund) should recommend to the Minister of Finance within one year:

- the formula by which benefit levels should be determined on a going-forward basis;
- the basis on which the levy paid by sponsors should be calculated;
- procedures for ensuring that both the benefits and the levy are adjusted at regular intervals; and
- any other matter relevant to the implementation of this recommendation.

The recommendations should be accompanied by a statement concerning the anticipated effects of any such adjustment. The Minister should act promptly upon receipt of these recommendations and the accompanying statement.

Armed with this report, and acting on the advice of the Minister, the Lieutenant Governor in Council will be able to put in place appropriate measures to ensure that active plan members and retirees receive a fair level of benefit protection, approximating that provided by the original statute, and that the levy needed to sustain that protection will be calculated in an objective manner.

Finally, I do not contemplate that MEPPs and JSPPs — plans presently excluded from PBGF coverage — should be included, nor should the proposed JGTBPPs.

6.4.4 The long-term future of the Pension Benefits Guarantee Fund and its relationship to the government

As noted above, the PBGF is somewhat anomalous in that no government agency provides similar guarantees in the pension sector of any Canadian jurisdiction. Functional counterparts do exist in other risk-based elements of the financial sector in Canada, though they are administered either through an arm's-length Crown corporation (Canada Deposit Insurance Corporation, for bank deposits and trust company investment certificates) or an industry-run not-for-profit organization (Assuris and PACICC for life and casualty insurance companies, respectively). As well, pension sponsors in several European countries have established self-insurance schemes that provide guarantees comparable to those offered in Ontario by the PBGF. Acknowledging that conditions in other financial sectors and in other countries' pension systems may differ from those of Ontario, it would nonetheless be sensible for Ontario to carefully investigate alternatives to the PBGF.

> **Recommendation 6-18** — The Ministry of Finance or some other agency, either alone or in cooperation with other Canadian pension authorities, should initiate a study of possible alternatives to the Pension Benefits Guarantee Fund. Unless and until such an alternative that provides comparable or better protection for active plan members and retirees can be identified, the Pension Benefits Guarantee Fund should continue to exist in the form proposed in Recommendations 6-14 to 6-17.

Given that the PBGF is likely to be with us for some time, it is important that the principles on which it is based should be clearly articulated, preferably in legislation.

> **Recommendation 6-19** — The Pension Benefits Guarantee Fund should be governed by the following principles:
>
> - The Fund should be self-financing.
> - It should not receive government grants or subsidies in order to meet its obligations.
> - It should be allowed to borrow funds from the government on a commercial basis, for defined purposes and at defined times.
> - The terms on which the Fund itself should be deemed insolvent, and the effects of such insolvency, should be clearly set out in the *Pension Benefits Act*.

Even if the principles governing the PBGF are embedded in legislation, future governments will likely be unwilling or unable to resist pressures to buffer workers and retirees from the consequences of the failure of a major pension plan. As noted, those consequences are extremely serious, not only for individuals, but for communities, and not only for pension funds, but for government welfare programs that will ultimately be called upon to provide the income lost by retirees in the event of such a failure. However, when and if the government feels it must intervene, it ought to do so outside the framework of the PBGF, which, after all, is based on insurance principles. This may be done by way of grants to the sponsor, the Fund or the local community; it may be done in the context of the restructuring of the sponsor; or it may be done through some adjustment in the eligibility criteria of government income support schemes. But it is inappropriate, in my view, for government to make *ad hoc* decisions that will affect the solvency of an insurance fund that was carefully built up through a process of sophisticated risk-assessment and paid for by sponsors who have every reason to expect that in the normal course, their contributions will be adequate to the task at hand.

6.5 Conclusion

As noted elsewhere, the changes I propose will take some time to implement. Some, especially in matters relating to bankruptcy and insolvency, ultimately depend on the federal government. Others require more extensive study than I could provide. Still others must be postponed to allow sponsors time to rearrange their affairs. However, some changes can be introduced more promptly, particularly those that relate to the powers of the regulator. Since these are mainly designed to promote the first of the three strategies proposed earlier in this chapter — enhanced vigilance and more proactive intervention by the regulator to detect and forestall plan failures — I am optimistic that such measures will produce relatively early improvements in the *status quo*.

Finally, it is important to place the changes recommended in this chapter in the context of those that precede and follow it. The emphasis in this chapter is on dealing with plans in, or on the verge of, extreme crisis. Understandably, therefore, its recommendations are designed to enhance protection for active plan members and retirees. In Chapters Four and Five, by contrast, the emphasis is on making pensions affordable and on facilitating the corporate transactions that are characteristic of a rapidly changing economy while improving protections for the rights and expectations of pension beneficiaries. In Chapters Seven and Eight, the emphasis shifts to improving the machinery of regulation and governance, which are of such vital concern not only to pension stakeholders, but to the community as a whole.

Hence the need for this reminder to readers: to focus on any one chapter or recommendation in isolation from all the others is to run the risk of missing the point that, taken together, they strike a fair balance between the interests of sponsors and those of active plan members and retirees, between security and affordability, and between effective regulation and respect for the capacity of the pension community to manage its own affairs. Striking a balance comes at a price, however. It requires that widely held understandings about what the pension system is and how it works be re-examined, that some long-established institutions and familiar ways of doing things be replaced by new ones, and that passionate convictions about how best to move Ontario's pension system forward be modified to accommodate similarly passionate — but opposing — convictions.

CHAPTER SEVEN – REGULATION

7.1 The Challenge of Regulating Occupational Pension Plans

Defined benefit (DB) pension plans present a particularly difficult regulatory challenge. Very large sums of money are involved; the stakes are high for Ontario employers, workers, retirees, investors, taxpayers and communities; and the pension promise — which is supposed to be calculated with precision — must somehow survive intact despite changes in life expectancy, corporate structures, career patterns, bond yields and equity returns. Not surprisingly, the legal regime governing pensions is very dense. And not only dense but complex: "pension law" comprises a somewhat ill-assorted mixture of common law doctrine and statutory rules; trust agreements and insurance contracts; professional standards and best practices; and elements of adjacent legal regimes governing taxation, insolvency, labour relations and intergovernmental relations. And not only dense and complex, but volatile as well: regulatory requirements are (or should be) adjusted frequently to take account of changing business conditions and financial markets, changing social facts and public policies, changing plan designs and funding approaches, and changing professional practices and regulatory technologies.

As a result, the substantive rules of the regulatory system are almost incomprehensible to anyone who is not an expert in the field — including most especially employers who must honour the pension promise and workers who are its beneficiaries. Pension plans, and their sponsors and beneficiaries, must therefore invest heavily in legal, actuarial, accounting, investment and other professional advice.

Finally, responsibility for the administration of "pension law" in the largest sense is widely distributed: (1) within the Financial Services Commission of Ontario (FSCO) as between the Superintendent of Financial Services and the Financial Services Tribunal (FST); (2) between ordinary courts of civil jurisdiction and those that undertake judicial review or the administration of insolvency, tax and criminal law; and (3) among a miscellany of other forums including professional standard-setting and disciplinary bodies; *ad hoc* arbitrators and labour tribunals; and — in the ordinary course of business — plan trustees, administrators, advisors and service providers who generate and enforce a form of "soft law." Pension disputes may therefore find their way — simultaneously or consecutively — into several different forums where decision-makers tend to interpret pension law in light of their own mandate and expertise. The results are sometimes unexpected, sometimes contradictory, and occasionally, I was told, disruptive of the whole pension system. To overcome such results, legislation and plan documents may have to be re-drafted, well-established practices revised, and new funding arrangements put in place — thus adding to the complexity and cost of the system.

It is no wonder, then, that so many briefs submitted to the Commission complained of the complexity of pension law, of its unpredictable character, of the costs and delays associated with attempts to vindicate the legal rights of sponsors or beneficiaries, and of the inefficiency and ineffectiveness of much of the regulatory apparatus. Each of those matters is addressed in this chapter.

7.2 Establishing Norms of Pension Regulation

7.2.1 Introduction

As suggested in Chapter One, an important principle informing the work of this Commission is the need to "coordinate pension policy with other policy domains and legal–regulatory regimes." This involves three aspects. The first is to ensure that elements of federal tax and insolvency law that bear on pension provision, entitlement, administration and security make sense in terms of Ontario's pension policy. In Chapters Four, Six and Ten, I make several recommendations to this end. The second is to secure greater convergence or harmonization among provincial pension regimes in order to minimize the paper burden for plans that operate across provincial boundaries. This is also the subject of a recommendation in Chapter Ten.

The third — dealt with next — is to better integrate provincial statutes with the principles and doctrines of common law and equity. Some briefs and submissions argued for the abolition or extension of "trust law" and for the primacy or suppression of "contract law;" others proposed codification of all pension law within an expanded *Pension Benefits Act* (PBA); and still others proposed that the PBA itself should become less an impenetrable collection of detailed rules and more a statement of general principles — supplemented by policy statements and, where deemed necessary, by binding regulations or rules.

7.2.2 Trust law and contract law

Many proposals either to "abolish" trust and contract law, or to extend their reach, were designed to change specific aspects of pension law that are presently or potentially grounded in trust or contract doctrine. The changes sought relate to such matters as the ownership of surplus on partial wind-ups, the imposition of fiduciary duties and the unilateral right of sponsors to alter the terms of a plan. I believe that it is preferable to treat such matters on their own merits, rather than as part of a general project to consolidate and simplify the law — and have done so elsewhere in this report.

7.2.3 Codification of pension law

There is much to be said for codifying pension law so that the PBA (and rules or regulations made pursuant to it) becomes the single, authoritative source of all substantive and procedural rules governing the field. First, this would ensure that disputes are resolved in a manner consistent with the logic of pension regulation, rather than with the logic of general legal doctrines, which originate in and encompass very different domains of social and economic conflict. Second, the rules can be framed in language that is familiar to people who deal with pension issues. And third, if carefully drafted, statutory provisions can reduce or eliminate ambiguities that generate expensive litigation and unexpected outcomes, which, as I have noted, may destabilize the pension system.

This last point requires explanation. It is unlikely that even the most carefully drafted statute can capture all contingencies, or that even the most comprehensive scheme of regulation will deter judges from dealing with pension-related issues that arise in other contexts such as, say, a dispute over the distribution of matrimonial property, the interpretation of a collective agreement or a challenge to the jurisdiction of the pension regulator. Nonetheless, a well-drafted and comprehensive PBA can do much to reduce the risks of inappropriate interpretations and the importation of doctrines and concepts from other fields of law into pension law. So, too, can a well-designed regulatory structure that consciously seeks to minimize, if not entirely eliminate, the role of the courts — a challenge addressed in sections 7.3 through 7.5 of this chapter. On the one hand, it is important to reduce incentives for interested parties to seek relief outside the regulatory structure laid down in the legislation; on the other, it is desirable to increase incentives for legislators to address pension issues in a comprehensive, integrated and timely fashion by appropriate amendments to the governing legislation. Indeed, all these are elements of one of the guiding principles of this report identified in Chapter One: to strive for clear, comprehensive, consistent and — where possible — codified regulation.

> **Recommendation 7-1** — So far as possible, substantive rules intended to define the rights and responsibilities of participants in the pension system should be set out in the *Pension Benefits Act* or rules and regulations made pursuant to it. If feasible as a matter of statutory drafting, the Act should convey the intention of the legislature that the Act should be treated as the exclusive source of pension law.

As I have noted in Chapter Four, the Act was originally designed to regulate DB single-employer plans (SEPPs). As a result, SEPPs represent the paradigm or model from which departures are allowed only by way of specific exceptions. Such exceptions are indeed provided — in the Act or in regulations — for multi-employer (MEPP), jointly sponsored (JSPP) or defined contribution (DC) plans. However, neither a single part of the Act, nor a single section, nor even a specific regulation, deals comprehensively with one or more of these "exceptional" plans. This seems both odd and undesirable: odd because only some 27% of all active plan members are presently enrolled in DB SEPPs; undesirable because future growth in pension coverage will almost certainly occur in "exceptional" non-SEPP plans.

A recurring theme of submissions to the Commission has been that "one size does not fit all." Clearly, different plan types — those already prominent, and others likely to be introduced in the future — should be acknowledged and accommodated within the regulatory scheme not as "exceptions," but as plans with distinctive characteristics presenting unique regulatory challenges.

> **Recommendation 7-2** — As a medium-term project, the PBA and regulations should be re-drafted so as to clearly articulate both (a) general principles applicable to all types of pension plans, and (b) comprehensive codes applicable to specific plan types.

7.2.4 Rules and principles in pension regulation

Recommendation 7-2 implies that principles, as well as rules, have a role to play in pension legislation. Indeed, several stakeholders argued in favour of a "principles-based" approach to regulation, such as that recently adopted by the U.K. Pension Regulator. Moreover, there has been considerable interest recently in principles-based regulation as part of a larger, long-term trend toward deregulation and self-regulation in various domains of social and economic activity. However, although elements of this approach appear in the guidelines for plan governance and capital accumulation developed by the Canadian Association of Pension

Supervisory Authorities (CAPSA), it has not yet been comprehensively studied or extensively applied in the pension field in Canada. Consequently, it may be useful to rehearse its key aspects in a little more detail.

Principles-based regulation typically involves the articulation of standards at a fairly high level of generality or abstraction. For example, the fiduciary duty imposed on administrators of pension plans to "exercise the care, due diligence and skill in the administration and investment of a pension fund that a person of ordinary prudence would in dealing with the property of another person" is an example of such a principle. This approach to the framing of regulatory norms requires regulators to focus on the quality of outcomes rather than on compliance with specific procedural requirements. And it requires sponsors, service providers and plan administrators to accept greater responsibility for the substantive judgments they make concerning compliance with the law. Proponents of a principles-based approach argue that open-textured statutory language can better deal with the changing circumstances mentioned in the introduction to this chapter, and can promote an approach by all actors that contributes to the overall health of the regulated field.

Rules-based regulation is often advanced as the alternative to a principles-based approach. Whereas principles-based regulation implies a compendium of broad principles from which may be deduced specific answers to any questions that arise in the course of plan administration, rules-based regulation implies the existence of an exhaustive code of clear and detailed rules with which every plan must comply. A principles-based approach, critics argue, can leave too much scope for regulatees to interpret the law in ways that suit them, does not provide them with sufficient guidance concerning funding obligations and benefit entitlements, and is not well-suited to the making of decisions that may have consequences far into the future when the regulatee may not be available to be held accountable.

Proponents of principles-based regulation counter that a rules-based approach can be excessively formal and inflexible — especially in areas in which the underlying industry changes rapidly — and that it permits regulatees to comply with the detailed letter of the law while skilfully avoiding its spirit and intent. In such circumstances, they note, regulators often find ways — imaginative interpretations, procedural improvisations or the establishment of materiality thresholds — to make rules behave more flexibly, like principles. They also point out that principles-based regimes are frequently — perhaps inevitably — supplemented by policy statements, advisory bulletins and other forms of regulatory "guidance," which may or may not have the force of law, but which if ignored by regulatees, are likely to result in adverse consequences. Principles, in other words, can be made to behave like rules.

Clearly, then, as Mary Condon's research conducted for the Commission shows, there are advantages and disadvantages to both approaches. Clearly, too, principles- and rules-based approaches can be blended to some degree — as proposed in Chapter Four in regard to the funding rules, and in Chapter Eight in regard to the governance and administration of plans.

Finally, the precise balance struck between rules and principles will heavily influence the optimal design, powers and staffing requirements of the pension regulator. Whatever balance is struck, it should be one that facilitates a guiding principle of this report: that of open, fair, effective and adaptable regulation.

Recommendation 7-3 — Revisions to the *Pension Benefits Act* should be drafted to provide both rules-based and principles-based approaches, as appropriate. In particular, minimum standards with respect to benefits should generally be rules-based; some aspects of investment, plan governance and innovation are more appropriately regulated by a principles-based approach; and funding requirements should likely involve a mixture of the two.

7.2.5 The role of professional standards in pension regulation

The PBA and its supporting regulations do not provide a comprehensive framework governing all conduct relevant to the administration of the pension system. They are supplemented to a considerable extent by detailed, technical rules promulgated by professional governing bodies — especially the Canadian Institute of Actuaries (CIA) — that prescribe how professional functions within their special area of competence must be performed. The means of performing a pension valuation is an important example of how professional standards fill a gap in the regulatory norms of the pension system.

However, it is important that public regulatory bodies not simply abdicate their responsibilities to professional bodies. In Chapter Four, I recommend that assumptions underlying actuarial valuations be made more precise, consistent and transparent. This could be accomplished either by amending the statute and regulations, or by the CIA undertaking a revision of its existing standards, which, I understand, they are in fact doing. The latter is clearly the preferable approach, but it leaves open the question of how to ensure that the CIA's revisions in fact produced the desired result.

Recommendation 7-4 — The government should accept ultimate responsibility for ensuring that all standards governing the conduct of professional and other participants in the pension system are appropriate and in the public interest.

The *Pension Benefits Act* and regulations should make clear provision for the adoption by reference of standards established by professional governing bodies such as the Canadian Institute of Actuaries. In addition, the pension regulator should work closely with professional governing bodies to ensure that the standards they establish, amend and apply to their own members from time to time are consistent with Ontario's pension law and policy. To the extent that they are not, they should be replaced with more appropriate standards laid down in the Act or by regulation.

This recommendation should lead to greater engagement between the regulator and professional bodies, with a view to determining the appropriate standards to be applied to major aspects of risk-based assessment and other regulatory mechanics. The constructive participation of stakeholders in this process should be assured, as well — as I recommend in Chapter Ten.

Various recommendations in this and other chapters — for more transparent decision-making, more careful risk management and more widespread self-governance — are likely to lead to increased reliance by plans on the pension professionals who provide them with actuarial, legal or accounting services. It will therefore become increasingly important to ensure that high standards of professional conduct are enforced. Enforcement may take the form of professional discipline proceedings, as at present. However, because professional standards are adopted by reference in the regulations, they acquire the force of law. Failure to observe them will then expose wrongdoers to regulatory sanctions under the PBA and, in some cases, to prosecution under the *Provincial Offences Act*. Hopefully, vigilant enforcement of standards by professional bodies — the CIA, the Law Society of Upper Canada or the Canadian Institute of Chartered Accountants — will suffice; but prior or subsequent administrative or criminal sanctions are not legally precluded by professional disciplinary proceedings. This issue is dealt with in greater detail in Chapter Eight.

7.2.6 Facilitating regulation for small plans

A frequent observation of stakeholders, confirmed by our research, was that small- and medium-sized enterprises (SMEs) are less likely than larger ones to have a pension plan, and that even fewer have a DB plan. While some SMEs are unable to afford to fund a pension plan, many — likely most — also lack the technical capacity to establish it and the in-house personnel to administer it in compliance with regulatory requirements. Given that one of the guiding principles of this report is to create a positive environment for DB plans within a voluntary system, these are issues that must be addressed.

In order to encourage SME sponsorship of pension plans, the PBA should provide an easy-to-use plain-language template that can be employed to initiate a pension plan with minimal legal or actuarial advice. Such templates are employed in connection with pension plans in other jurisdictions and, in Ontario, in other non-pension contexts, including "short forms" of various instruments used to transfer real property. In addition, some pension regimes provide for simplified registration procedures, valuations and annual filings for plans under a certain size. These would all be important ways of assisting SMEs that wish to provide pension coverage for their workers, and thus of promoting the expansion of pension coverage in a sector where it has considerable room to grow.

> **Recommendation 7-5** — Legislation should provide standard-form or template plans, particularly for the use of small- and medium-sized enterprises, and the regulator should develop simplified registration and filing requirements for such plans.

Template plans and simplified procedures will obviously not transform pension coverage among SMEs in and of themselves. However, they can at the very least remove some barriers to participation in the DB system for SMEs that wish to do so. No less important will be the measures, outlined in Chapter Nine, to facilitate the provision of investment and service packages to smaller plans, as well as other innovations that, I hope, will appeal especially to SMEs.

In addition to facilitating SME pension plans, there is a case to be made for minimizing the regulatory requirements for, and oversight of, "designated plans" or "individual pension plans." These very small plans, established under special provisions of the *Income Tax Act* (ITA), are for the benefit of senior executives who, unlike most plan members, are typically able to protect their own interests and therefore do not require a high level of regulatory protection.

Recommendation 7-6 — Simplified registration and filing requirements should be adopted for designated or individual pension plans for senior executives. In addition, a protocol should be developed to identify a minimum membership threshold for plans below which the regulator should react to complaints, but not provide its normal level of regulatory oversight.

7.3 Functions of the Pension Regulator

7.3.1 Introduction

FSCO — like its counterparts elsewhere — administers its statute and regulates the pension sector by maintaining various forms of oversight: *passive* (monitoring routine filings), *active* (providing approvals, issuing advisories and rulings), *proactive* (conducting audits and investigations), and *reactive* (responding to information or complaints from active and retired members, creditors or service providers).

All of these activities are valuable in themselves. Moreover, they offer a unique opportunity for the regulator to accumulate detailed information about the pension system as a whole, and about its constituent elements identified by plan type, risk exposure, employment sector or other characteristics. Elsewhere in this chapter, and in other chapters, I have underlined the need to collect and analyse systemic data as a foundation for the policy architecture of the system. In the present context, however, I note that extensive data collection and analysis will also enable the regulator to develop more reliable benchmarks by which to evaluate the performance of individual plans, often by means of algorithms that identify problem plans — a key feature of principles- and risk-based systems. The availability of such data also enables the regulator to evaluate its own work, make necessary changes in its procedures and practices, deploy its available resources where they are most needed, and make a persuasive case for new powers and personnel.

Further, in addition to its oversight functions, a pension regulator may be called on to defend the integrity of the pension system, whether through civil, criminal or administrative proceedings. Where administrative proceedings are mandated, as in Ontario, the regulator must establish and maintain fair and efficient dispute-resolving and decision-making processes with a capacity to deliver "graduated responses" appropriate to problems of differing urgency and intensity.

Finally, the regulator must constantly engage with stakeholders, mediate their conflicts and, on occasion, advocate on behalf of those whose interests are adversely affected but who lack the means to protect themselves. These functions imply that the regulator ought to commit significant resources to communicating to stakeholders and government concerning its work and general conditions that may affect the health of the pension sector.

This section of Chapter Seven is organized around a description and analysis of the four types of oversight listed above.

7.3.2 Passive oversight: monitoring periodic filings and compiling data

One of the most basic functions of the regulator is to ensure compliance with the PBA by monitoring reports filed by pension plan administrators. FSCO receives about 19,000 filings per year, including standard annual or triennial actuarial reports; annual information returns (AIRs); annual investment information summaries (IISs); summaries of contributions; cost certificates for the Pension Benefits Guarantee Fund (PBGF); and a miscellany of filings dealing with individual member or plan concerns, notices or applications in relation to plan amendments and other transactions.

AIRs record the plan's basic characteristics and administrative information, including membership and financial data, information concerning the presence (if any) of a collective bargaining agent representing active plan members, the identity of custodial trustees, and other "tombstone" data that forms part of the profile of a pension plan once it has been registered. FSCO maintains data derived from AIRs in a consolidated database.

I described actuarial valuations in some detail in Chapter Four. When submitted to FSCO in the normal course of reporting, valuations are accompanied by a standard-form Actuarial Information Summary (AIS), which displays information about the assets, liabilities and funded status of the plan. A database built from AIS submissions is FSCO's main tool for its risk-based assessment of plans.

The IISs — a recent innovation — contain somewhat more detailed information about plan assets. They are therefore essential to FSCO's attempts to implement a risk-based approach to regulation. However, IISs presently provide a narrower range of data than they might. As risk-based regulation grows, also to likely increase is the importance and length of IISs and other required filings.

Sponsor contributions to a plan are normally remitted on a monthly basis to the plan administrator, and by the administrator to a custodial trustee such as a trust company. If contributions are not received, the custodial trustee must report this fact promptly; otherwise, contributions are simply reported annually to FSCO. Similarly, the PBGF cost certificate records receipt of the annual premium that the plan must pay to the PBGF. Non-payment of contributions or PBGF premiums is often a sign that the plan or the sponsor is in difficulty. Notice of non-payment should be required within a short period and the regulator should react promptly to any default. However, it is not clear to me that the present system contains a "red alert" function.

Certain filings — including the AIR and IIS — are performed electronically and monitored by FSCO in support of its risk-based analysis. Others are reviewed perfunctorily for timeliness. Still others — as FSCO frankly acknowledges — are filed without any review or response. Sponsors may not know whether their filings have been received, reviewed or "approved," or whether they are deficient. This is not a desirable state of affairs. Standard filings are the main instrument for monitoring compliance. They should be reviewed and approved — or challenged — within reasonable periods of time, and sponsors should know that they will be.

Because FSCO does not collect all information it might use, review consistently and analyse in timely fashion all filings it does receive, or receive all filings in electronic form, it cannot make full use of the data it does collect. Reasons for this situation include a lack of capacity and resources, and too exclusive focus on immediate and critical plan-specific issues rather than on broader compliance patterns and their implications for regulatory re-engineering. As a result, during the current period of rapid economic change, FSCO has been effectively reduced to attempting to maintain "bare compliance" with the PBA by individual plans. It certainly cannot operate a sophisticated and effective risk-based system with its current limited capacities. Nor can it — as presently constituted and resourced — support effective implementation of many of the recommendations contained in this report.

> **Recommendation 7-7** — The pension regulator should develop filing requirements, processes and review procedures that enable it to better discharge its compliance, risk-assessment and data-gathering mandate. It should develop an electronic system for the timely review of filings and for the development of useful interrelated databases and reports.

Finally, filings should also be designed with a view not only to monitoring compliance by individual plans, but to aggregating data for other purposes — especially to support policy research and development. FSCO presently conducts some policy analysis with a focus on its own regulatory activities. It also participates in initiatives of CAPSA — the national association of pension regulators — which has developed model laws and reciprocal agreements dealing especially with plan governance and funding provisions. This is useful and necessary work. However, detailed policy development for Ontario-specific issues is lacking. For example, FSCO has undertaken no significant analysis of labour market developments — the principal source of changes in pension coverage. Nor could it easily do so: it has only one full-time staff member with significant experience in data collection and related economic and social policy analysis. But someone must. I return to this issue in Chapter Ten, but stress again that regulatory enhancements and fundamental policy development both draw sustenance from the same data source: filings with FSCO.

7.3.3 Active oversight: reviewing and approving transactions

One of the regulator's primary functions is reviewing and approving major pension plan transactions, such as splits, mergers and conversions, all of which are dealt with in Chapter Five. As noted in that chapter, FSCO has had great difficulty in processing these approvals in a timely fashion, both because of delays attributable to complexities or ambiguities in the law and because the Notice of Proposal (NOP) approvals procedure mandated by the PBA is awkward. However, I am optimistic that changes I have recommended will improve the situation by providing greater legal clarity and more appropriate procedures.

If these recommendations are adopted, the NOP procedures will no longer apply to major plan transactions. Nor, if the next recommendation is implemented, would they apply to action taken by the Superintendent in her or his general oversight of plan administration.

> **Recommendation 7-8** — The present Notice of Proposal procedures should be repealed.
>
> Applications seeking approval for major plan transactions should be dealt with in accordance with Recommendations 5-17 to 5-22.
>
> Applications involving routine processing of other matters should be dealt with on the basis of a file review by the Superintendent. Other, more important matters should be dealt with pursuant to the procedures proposed in Recommendation 7-15.

> The Superintendent should have power to approve, disapprove or issue directives concerning the matter at hand. Decisions of the Superintendent should be subject to appeal to and enforceable by the proposed Pension Tribunal of Ontario.

These expedited procedures should ensure that parties to a concluded transaction receive a more rapid determination of its legality. However, they do nothing to assist sponsors in assessing possible objections to future transactions. It is important to provide some kind of advance indication of the likely regulatory reaction to possible or pending transactions for two reasons. First, this might assist sponsors in structuring transactions from the outset so that they meet regulatory requirements. Second, it might save other parties affected by the transaction the time and expense associated with participation in the approvals process and subsequent appeals.

At present, FSCO sometimes provides feedback by discussing prospective transactions informally with the parties. FSCO also issues policy statements from time to time for the guidance of future applicants and, presumably, other interested parties. In addition, the Superintendent occasionally provides opinion letters about such transactions prior to their consummation, although this is done *ad hoc* with no clear supporting procedures in the PBA or regulations. And finally, some regulatory bodies (but not FSCO) issue advance rulings that are binding in a practical, if not technical legal, sense.

It would be useful to clarify and regularize these four somewhat different procedures. The first — informal discussion — is somewhat problematic. It is not transparent and it cannot, in the nature of an informal discussion, involve careful consideration. However, it is obviously "without prejudice" and neither binds nor predisposes the regulator; it contemplates full and fair ventilation of the issues at a subsequent hearing; and it allows the regulator to be helpful to a key client constituency. Still, informal discussions should be approached with caution on both sides. The second — issuing policy statements — is the most straightforward. It has a number of positive features: it allows time for careful consideration by the regulator; it does not involve prejudgment of any particular transaction; and it is transparent. FSCO should issue such statements more frequently, systematically and following consultation with stakeholders.

> **Recommendation 7-9** — The pension regulator should issue policy statements indicating how it views and intends to process all standard pension transactions. Before doing so, it should give notice of its intention to issue such statements, and provide stakeholders with an opportunity to submit comments. After doing so, while not bound by such statements, the regulator should depart from them only for good reason and, preferably, by way of an amending statement rather than in the context of a particular proceeding.

The third and fourth options — the provision of opinion letters, and advance rulings — pose the greatest difficulty. Opinion letters indicate prejudgment of the issues; they are usually given to a prospective applicant *ex parte* so that other affected parties do not have a chance to register their views; and such letters require full and frank disclosure of the facts by the applicant, who may be unwilling or unable to make such disclosure at an early stage in the transaction. For these reasons, no doubt, opinion letters are not usually considered binding. Advance rulings, by contrast, are usually made after all affected parties are afforded an opportunity to provide their views and, though *prima facie* binding, can presumably be set aside if disclosure or other requirements have not been met.

Opinion letters and advance rulings have proved useful in other regulatory contexts; with proper safeguards, they should be available in the pension field as well. Advance rulings may facilitate decision-making by the sponsor, the administrator or third parties, provide some degree of comfort concerning complicated major transactions that affect both the plan and the sponsor, engage members and other stakeholders in decision-making before rather than after the fact, and potentially reduce the incidence of non-compliance and the unnecessary use of regulatory resources. They would certainly help to reduce the serious delays that presently compromise the approvals process.

> **Recommendation 7-10** — The pension regulator should have power to provide opinion letters and advance rulings in connection with proposed or pending transactions. The regulator should feel free to disregard such letters or rulings in subsequent proceedings if the applicant has not made full disclosure of relevant facts; if they adversely affect other parties who have not had a prior opportunity to be heard; or if they contravene legal rules or regulatory policies that were not in force when the letter or ruling was issued.

7.3.4 Proactive oversight: monitoring, audits and investigations

A third important function of the regulator is proactive monitoring of pension plans. Currently, FSCO has no clearly defined policy of conducting random audits, field visits or other proactive monitoring activities as does, for example, the federal pension regulator, the Office of the Superintendent of Financial Institutions (OSFI).

Either on its own initiative or in response to complaints, FSCO has conducted some reviews of plans and sectors it deems at risk. However, these reviews, and the ensuing investigations, are regarded as having yielded relatively little regulatory impact. For example, FSCO recently completed a review of all MEPPs in the province, singling out two for special attention because they had been the subject of member complaints. This review — which consumed significant staff resources and occasioned some disruption of ongoing regulatory functions — resulted in charges being brought against only one plan.

The success of a proactive strategy cannot, of course, be measured only by the number of charges it generates. It may have other potential benefits, including the generation of systemic information (which FSCO is not presently able to use to full advantage) and deterrence of non-compliant plans, which will not wish to be caught in some future proactive initiative (effects that are impossible to measure). However, at the very least, FSCO's recent experience suggests the need to develop a more sophisticated approach to proactive oversight, and the development of benchmarks with which to identify potential targets and evaluate the utility of this approach. For example, the failure of a number of plans in the manufacturing sector after 2000 might have led FSCO to develop a profile of plans deserving special attention by way of "field visits" or unscheduled "spot" audits. Similar proactive measures might help to pre-empt or mitigate failures in the event of a comparable sectoral crisis in the future. Indeed, such measures are virtually indispensable, especially in regulatory domains where a risk-based strategy is being pursued.

The following recommendation is designed to take the regulator much farther down the path to proactive oversight than at present.

Recommendation 7-11 — The regulator should:

- develop a program of proactive monitoring, auditing, inspections and investigations directed especially at plans whose profiles, sponsors' profiles or sectoral location suggest that they may be at risk of failure or of significant under-funding;
- expand and update its existing systems for monitoring risks, ensure that these systems are designed and administered by expert staff, and supplement them with other strategies for detecting plans at risk; and
- be empowered to undertake remedial measures based on the results of its proactive monitoring.

7.3.5 Reactive oversight: responding to inquiries and complaints

Like all successful regulators, FSCO engages in reactive oversight: it responds to inquiries and complaints.

Inquiries to FSCO by active and retired plan members and other stakeholders appear to be rising rapidly — from about 650 in 2002 to 1,000 in 2007 — perhaps due to changing economic conditions. If so, inquiries will continue to consume an increasing proportion of regulatory resources. FSCO's standard response is to advise those with queries or complaints to first approach their plan administrator and, if no satisfaction is obtained, to return to FSCO and initiate a written inquiry or complaint. About 80% of initial inquiries are "resolved" in this way, although there is no way of knowing whether the member received satisfaction or merely became discouraged and abandoned his or her inquiry. About 20% of these inquiries result in some action by FSCO, ranging from corresponding with the plan administrator to an order by the Superintendent requiring remedial action to — very rarely — prosecution.

Unfortunately, FSCO's analysis of inquiries and complaints leaves much to be desired. It has not analysed the increase in inquiries or complaints; it does not provide a detailed breakdown of types of inquiry or rank them by degrees of seriousness; it does not define "resolution" or track outcomes or complainant satisfaction with outcomes. However, FSCO does have an internal system for encouraging informal resolution of complaints by members against sponsors and administrators, and does intervene if resolution is not achieved. Perhaps this system is operating well; perhaps it is not. In the former case, FSCO ought to be able to claim credit; in the latter, it ought to be able to correct shortcomings; but it can do neither because it does not have adequate information about the operation of its own system.

Recommendation 7-12 — The regulator should develop a set of internal controls to better understand the provenance, track the processing and evaluate the outcome of inquiries and complaints; use the results of this process to improve its performance; and communicate those results to stakeholders.

7.3.6 Facilitating access to the regulatory process by active and retired members

During the Commission's hearings I received a number of representations to the effect that FSCO was not vigilant in protecting the interests of active and retired members; that it was not responsive to their inquiries, that it declined to provide information to which people felt they were entitled or that it made information available only through an expensive or awkward process; and in general, that FSCO was not "member- or retiree-friendly." I am in no position to judge how fair or otherwise are these characterizations of FSCO, and I acknowledge that many of them may have come from individuals who had been hurt by plan failures for which FSCO was not ultimately responsible. However, any organization ought to be concerned if a significant number of its "clients" — those in whose interests it is meant to be acting — regard it in such a negative light.

This is especially true in the field of pensions, which, like the process that regulates them, is difficult to understand. These two difficulties — a complex subject and an opaque process — make it all the more necessary that the regulator devote greater attention to improving service to active and retired members. Other regulatory bodies develop strategies (information pamphlets, DVDs, on-line information) and employ personnel (complaints officer, ombudsperson or client advocate) to ensure that clients are, and perceive themselves to be, well served. The pension regulator ought to do likewise.

> **Recommendation 7-13** — The regulator should appoint a Complaints Officer with a mandate and supporting staff to assist complainants and persons making inquiries to secure the information they seek and the recourse to which they are entitled; to ensure the timely and responsive processing of inquiries and complaints; and to advocate on behalf of complainants within the regulatory process, where appropriate.

Another approach to the problem of enhancing access to the process for active and retired members is to facilitate advocacy on their behalf by unions or other representative organizations. Such groups often have trained pension staff or experienced pension volunteers who can provide advice to their members and appear as effective advocates on their behalf. Some have sufficient resources to hire lawyers or other pension professionals when required. Nonetheless, for almost all such groups — especially those organized *ad hoc* in response to a crisis in their pension plan — funding is a problem.

Reference to representative organizations raises another difficulty. A significant majority of plan members are represented by unions. However, some are not. Where there is no union, an effective union-substitute — such as a university faculty association or a retirees association — may exist. Or employees may form an *ad hoc* association to deal with the consequences of their employer's insolvency and the associated failure of their pension plan. In such cases, the union is legally entitled to speak for all members of the bargaining unit (but not retirees) and a representative organization other than a union may represent their members (but not non-members). Furthermore, in some cases, individuals who might otherwise seek to be represented by their union are in fact in conflict with it — as, for example, when members feel that a union-dominated board of trustees is acting improperly. Thus there will always be ambiguous cases where the right of the representative organization to appear on behalf of particular individuals is called into question, or where individuals will wish to have separate representation.

Recommendation 7-14 — The *Pension Benefits Act* should clearly establish the right of unions and other representative organizations to participate in regulatory proceedings on behalf of individuals whom they represent, and of individuals to represent themselves. The Pension Tribunal of Ontario should be given discretion to order the sponsor or the plan to reimburse all legal and other costs necessarily incurred in the course of such participation in appropriate cases when claims or complaints are meritorious.

7.3.7 Securing compliance: administrative, civil and criminal sanctions

Most sponsors, pension professionals, trustees and service providers are knowledgeable, conscientious and law-abiding. However, this does not ensure that they are always in compliance with all of the regulatory requirements in the PBA. Some non-compliant conduct may result from inadvertence, some from misunderstanding of what the statute requires, some from ambiguities inherent in the roles assigned to various actors, and some — a very few — from deliberate decisions to break the law. Moreover, non-compliance ranges in seriousness from what might be called technical misdemeanours (such as late filing of a report), to clearly criminal conduct (such as falsification of information with intent to deceive).

To bring compliance as near to 100% as can be achieved, the regulator ought to have a number of strategies at its disposal. Disseminating information, dispelling misunderstandings, resolving ambiguities, developing open and cooperative relationships, providing positive incentives for willing compliance and forgiveness for innocent and minor transgressions are — and should be — part of any regulator's repertoire. Nonetheless, significant and intentional violations will occur and must be dealt with.

The PBA gives the Superintendent three broad powers to secure compliance. The Superintendent may refuse to register a plan or a plan amendment, or revoke the registration of a plan that is not in compliance with the PBA. The Superintendent also has seemingly open-ended — but apparently untested — power to "require an administrator or any other person to take or refrain from taking any action in respect of a pension plan or a pension fund" not in compliance with the PBA. And the Superintendent may prosecute anyone for violating the Act, and ask the convicting court not only to impose a significant fine but also to order the sponsor — and its officers and directors personally — to pay monies owing to the plan. In addition, the administrator of any plan (but not, for some reason, the Superintendent) may sue civilly to restrain contraventions.

The Superintendent also has supplementary powers to deal with specified circumstances, such as the power to order the wind-up of a plan, to challenge actuarial assumptions and methods, to require certain types of disclosure, and to replace a plan administrator. And finally, as discussed above, the Superintendent's consent is required for some types of transactions.

A study for the Commission by Lorne Sossin of FSCO's regulatory powers and practices was circumscribed by the limited availability of data describing FSCO's formal and informal efforts to secure compliance. As a result, it is difficult to come to any clear conclusions about how often and to what effect the Superintendent uses these statutory enforcement powers. Apparently, the Superintendent each year issues about 15 declarations, makes some 25 orders, and initiates about 100 NOPs (discussed above), in addition to Letters of Caution, Minutes of Settlement and other informal dispositions. However, none of these numbers is linked to an assessment of regulatory outcomes and all may well be understated.

What does seem clear, however, is that prosecution is seldom used — and perhaps for good reason. The need to explain the complexities of pension legislation to a judge unfamiliar with the field, to persuade that judge to impose significant penalties for a “white collar crime,” and to meet the criminal standard of proof are but three of the reasons that prosecution under the *Provincial Offences Act* is an unattractive option. Indeed, FSCO’s recent expensive but unsuccessful attempt to prosecute an actuary whose reports allegedly contravened the Act reinforces this conclusion. (The actuary eventually pleaded guilty in CIA disciplinary proceedings to a charge of professional misconduct, was fined and was suspended from pension practice for six months.)

It is not clear to me whether what appears to be a relatively low level of enforcement activity can be explained by a relatively low level of non-compliance, or by the unsuitable nature of the enforcement options available to the Superintendent, or by the success of informal, non-statutory strategies he or she has developed. But nor — on the basis of published information — does the Superintendent appear to know. I believe the Superintendent should know, and should have the necessary means to do so.

It is particularly important that a new enforcement strategy be put in place to complement the new approach to regulation proposed elsewhere in this report. In general, that new approach encompasses greater reliance on shaping conduct through principles augmented by guidelines, on extensive and open interaction between the regulator and the regulatees, and on the sophisticated monitoring and analysis of outcomes over long periods of time. What keeps such a trust-based system “honest” is the certain knowledge that violations will be promptly detected, that defaults will be corrected and that deliberate wrongdoing will be severely punished. The regulator, in other words, needs a large toolkit to enable graduated responses to be made to the situation at hand. Those tools must include both surgical instruments for the detection and correction of violations, and blunter instruments for punishment. Through a series of recommendations in earlier chapters, I have already proposed to provide the Superintendent with new or reinforced power to:

- review the plan’s selection of actuarial assumptions;
- give selective relief from contribution increases to certain plans;
- order interim valuations of plans at risk;
- conduct spot checks of filings;
- require a wind-up under certain circumstances;
- review the potential effects of mergers, splits and asset transfers;
- establish risk-assessment benchmarks and order additional actuarial valuations;
- approve arrangements notwithstanding the plan documents, under certain conditions;
- seek unpaid contributions from delinquent sponsors; and
- approve arrangements relating to a restructuring, and appoint administrators for insolvent or failing sponsors.

This list will be augmented by several additional recommendations I make in section 7.4 of this chapter and elsewhere. In general terms, however, a more expansive approach should be taken to the Superintendent’s powers than is possible under the existing NOP procedures. As noted above, the Act already gives the

Superintendent the power to "require an administrator or any other person to take or refrain from taking any action in respect of a pension plan or a pension fund." This broad and potentially useful power should fill the gap left by the abolition of the NOP procedure, as proposed in Recommendation 7-8, above. To facilitate its use, the procedural and remedial dimensions of the Superintendent's power to deal with violations of the PBA and other contested matters should be more clearly specified.

> **Recommendation 7-15** — The *Pension Benefits Act* should grant the Superintendent power to:
>
> - hold hearings, require the production of documents and the giving of testimony, receive and rely on valuations and reports submitted in the regular course of his or her oversight functions, and order the preparation of and rely upon special valuations and reports;
> - make interim orders with effect for not more than 30 days — unless extended by the proposed Pension Tribunal of Ontario — on the basis of written documents, valuations, reports and submissions, where necessary to preserve the assets of a pension plan; and
> - make any final order necessary to secure compliance with the Act or with regulations and rules made pursuant to the Act.
>
> The Superintendent should provide all affected parties with as full a right to be heard as is feasible given the urgency of the situation.
>
> Orders of the Superintendent should be enforceable by the Pension Tribunal of Ontario. All decisions and orders of the Superintendent should be subject to appeal to the Tribunal.

A guiding principle in the development and use of these powers should be the need for the Superintendent to be able to make graduated responses to emerging problems encountered in the context of a complex and rapidly evolving system.

7.3.8 Reporting on regulatory activity

A good regulator must be able to evaluate its own performance, and to communicate its findings internally and externally. As I have noted several times, however, FSCO's evaluation and reporting mechanisms are inadequate.

FSCO employs five principal monitoring procedures that focus mainly on work-flow and timing. However, apart from the fact that FSCO itself makes limited use of these procedures, the conclusions they produce are not open to the public. FSCO maintains a website and a print publication and e-bulletin, which report selectively on its enforcement activities. These are also reviewed in its annual report and in an annual risk monitoring survey, which provides a summary of funding information across the pension system.

This is all useful, so far as it goes; but it does not go far enough. The regulator should initiate better data collection and more extensive analysis of its work, in regard both to enforcement and other matters. It should include in this analysis:

- performance objectives related to each major function of the regulator (passive, active, proactive and reactive oversight; advocacy and facilitation; data gathering and enforcement);
- accurate data measuring the regulator's performance of these functions and its achievement of performance objectives;
- benchmarks to facilitate comparison of performance improvements over time;
- surveys of stakeholder perceptions concerning the regulator's performance; and
- implications of its performance evaluation for regulatory reform, resource allocation and other aspects of its future development.

I do not mean to develop a template for such analysis. I do, however, strongly recommend that the pension regulator should do so.

> **Recommendation 7-16** — The regulator should improve its internal and external data collection and reporting activities and implement a program of rigorous self-evaluation that will contribute to the identification of possible improvements in its regulatory functions. It should make the results of this self-evaluation publicly available. The regulator should be given the human and material resources necessary to pursue this approach.

7.4 Re-inventing the Pension Regulator

If there was a single issue on which something like consensus emerged during the Commission's public hearings, it was that FSCO is not operating as well as it should. Not far behind was the frequent observation that FSCO could do its job better only if given the mandate, powers and personnel it presently lacks. Both the diagnosis and the prescription were supported by research studies that directly addressed issues of regulatory design, as well as those that dealt with the regulator's role in specific contexts, such as funding or plan failure. The research studies supported many of the anecdotal claims made at the hearings concerning regulatory delays and deficient performance. It illuminated a number of key regulatory reforms needed, in any event, but critical, if my recommendations for substantive reform are to be successfully implemented.

7.4.1 A renewed regulatory mandate

The Commission heard from a number of stakeholders about the current lack of a positive regulatory mandate for FSCO, symbolically represented by the absence of a "purpose clause" of the kind found in some regulatory statutes, and once enshrined in the PBA itself. The previous regulator, the Pension Commission of Ontario (PCO), was specifically enjoined to "promote the establishment, extension and improvement of pension plans throughout Ontario." This language, some claim, informed the PCO's approach to regulation and was one of the factors that led reviewing courts to defer to its decisions. By contrast, FSCO — with essentially similar regulatory functions — has a more anodyne, less ambitious, purpose clause: to "enhance the public interest and public confidence" in the pension system.

No mandate, no purpose clause, will enable the regulatory process to proceed, as it were, on automatic pilot. There will always be choices to make, always disagreements about which of those choices best serves the multiple — and sometimes conflicting — goals of the pension system. Nonetheless, a mandate captured in a purpose clause that gives positive direction to the regulator will serve as a benchmark enabling it to assess its own accomplishments, as a guide to the deployment of its resources, as a unifying principle that it can use to resolve difficulties over the interpretation of its statute, and as the recurring *motif* of a system of pension regulation that is increasingly principles-based. As noted earlier, such a clause may also remind courts dealing with pension legislation — whether in review or appellate proceedings, or otherwise — that the PBA must be read in light of its purposes, and that the achievement of those purposes was confided by the legislature to an expert regulatory body whose interpretations should be treated with respect. Finally, a purpose clause is a statement by the legislature of its own commitment to stated policy goals. At a moment when the future of the pension system is a matter of considerable concern and debate, reaffirmation of its purposes would send a clear signal to the stakeholders and to the general community.

> **Recommendation 7-17** — The *Pension Benefits Act* should include a "purpose clause" that will provide guidance to its interpretation and implementation. That clause should include reference to the need to maintain a balance among stakeholder interests, to keep pensions both secure and affordable, to both protect and promote the pension system, and to encourage innovation within the system.

7.4.2 A new institutional framework

As noted above, until 1997 administration of the PBA was assigned to a regulatory body — the PCO — exclusively concerned with this particular domain of public policy. In 1997, regulation of the pension field was reassigned to FSCO, which was also given jurisdiction over mortgage and trust companies, insurance companies, co-operatives and credit unions. FSCO's constituent statute created three new structures:

- FSCO — a five-member Commission responsible for "provid[ing] regulatory services that protect the public interest and enhance public confidence in the regulated sectors" under the *Financial Services Commission Act*;
- the Superintendent, who is the chief executive officer of FSCO (the regulator); and
- the FST — an adjudicative body to which the Superintendent's decisions may be appealed or through which they may be enforced.

FSCO — and each of its constituent elements — is funded by user fees on a cost-recovery basis. However, the fees are paid into the government's consolidated revenue fund and FSCO's budget is in turn paid out of the government's general revenue account. Fees paid by each regulatory sector are fixed and accounted for separately. For reasons explored below, these funding and budgeting arrangements are not optimal.

While the 1997 amalgamation of regulation in the financial services sector was presumably intended to integrate regulatory functions and rationalize the use of staff resources across the entire sector, integration and rationalization have in fact been minimal. There is almost no integration of strategic planning and institutional development across the different policy domains administered by FSCO. Indeed, the pension staff, including many former PCO employees, operates within FSCO with a good degree of functional autonomy — except for some legal and enforcement personnel who perform services for all five sectors regulated by FSCO (an arrangement, I was told, that has some negative aspects). In the absence of any comprehensive evaluation of the 1997 amalgamation, or indeed of any evidence at all suggesting that common concerns have been pursued or that regulatory synergies have been achieved, it is hard to justify continuation of a single multi-purpose financial sector regulator.

To the contrary, briefs and research studies suggested that the 1997 amalgamation may have been harmful to pension regulation. FSCO is obliged to "have regard" to the Minister of Finance's policy statements in the course of its decision-making, and is mandated to contribute to policy development by the Ministry. However, no policy statements appear to have been issued by the Minister, and FSCO has not contributed materially to the overall development of pension policy (except in relation to issues closely related to its regulatory functions). While this arrangement no doubt contributes to FSCO's independence, and to that of the Superintendent and the FST, it is perceived by many to detract from the close integration of regulation and policy-making to the prejudice of both. In this respect, FSCO is compared unfavourably with its predecessor, the PCO. Moreover, some observers believe that FSCO's relative detachment from the policy process has made decisions of the Superintendent and the FST more vulnerable to being reversed in court, though evidence on this point (canvassed below) is equivocal.

Both of these issues — the distancing of policy from regulation, and the enhanced risk of reversal — are matters that give me some concern. However, of greatest concern is the improbability that changes in pension policy and regulation, and in the human and financial resources and legal powers needed to support those changes, can be achieved within the context of a large multi-purpose organization. While framed somewhat differently, I take this also to be the purport of stakeholder submissions proposing re-establishment of the old PCO, or of a new pension agency with a structure, funding, powers and administrative autonomy akin to those of the Ontario Securities Commission (OSC). These suggestions, and others, converge on the establishment of a single-purpose pension regulator with an animating purpose, regulatory and adjudicative functions, and with clear independence from government.

In my view, establishing a new, independent single-purpose pension regulator would indeed yield significant benefits. Only such a regulator could possibly muster the capacity and develop the expertise to administer the regulatory approaches recommended elsewhere in this report, including principles-based reforms to the PBA, pro-active and risk-based regulatory strategies, the promotion of improved plan governance, the use of expanded rule-making powers and the facilitation of more rapid innovation.

> **Recommendation 7-18** — An independent pension regulator — the Ontario Pension Regulator — should be established with budgetary, staffing and other powers of self-management comparable to those of the Ontario Securities Commission.

> **Recommendation 7-19** — The Ontario Pension Regulator should comprise five commissioners — the Superintendent of Pensions and four independent, part-time commissioners with extensive experience in pensions regulation or policy. The commissioners should act as a board of directors with general power to:

- oversee and direct the functions of the Ontario Pension Regulator;
- approve its budget and administration;
- approve policies and issue policy statements relating to regulatory approaches;
- adopt procedural rules; and
- report annually to the Minister of Finance concerning the operations of the Regulator.

The commissioners should not perform operational regulatory functions involving individual plans.

Recommendation 7-20 — The Ontario Pension Regulator and the Superintendent of Pensions should exercise all pension-related functions now exercised by the Financial Services Commission of Ontario and the Superintendent of Financial Services, respectively, together with the additional functions recommended in this report.

However, this concentration by the Ontario Pension Regulator (OPR) on its enhanced oversight and remedial functions leads me to conclude — with some hesitation — that primary responsibility for overall pension policy ought to reside elsewhere. In Chapter Ten I recommend that a Pension Champion — either free-standing or inside the Ministry of Finance — should take the lead in developing pension policy and promoting non-statutory innovation in the pension system. I do contemplate that FSCO — or OPR if it succeeds to FSCO's regulatory responsibilities — will be the crucial source of information concerning sponsors, pension plans and their active and retired members; that it will contribute its unique, experience-based insights to larger discussions of pension reform; and that it will develop policies related to the exercise of its own powers. But it will not be the primary source of larger, long-term initiatives in pension policy development.

Recommendation 7-21 — The new Ontario Pension Regulator should assist in the development of pension policy by collecting data, contributing its experienced-based insights into the operation of the regulatory system and refining and reflecting on the exercise of its statutory powers. However, it should not be assigned primary responsibility for overall pension policy development.

7.4.3 Enhanced resources, funding and staffing

A number of submissions to the Commission suggested that inadequate oversight, long delays, inconsistent treatment and awkward relationships with its "clientele" have resulted from FSCO's inability to hire sufficient staff or to retain key professionals and experts. A review of the staffing model of FSCO's pension branch suggests that this diagnosis is likely correct.

The problem has several dimensions. First, pension staff within FSCO must "compete" for shared resources with the four other sectors regulated by FSCO. This problem will be resolved if, as recommended above, FSCO is replaced by a free-standing pension regulator. Second, FSCO has great difficulty in recruiting and retaining senior actuaries, lawyers, analysts and other expert personnel because its pay scales are fixed — not by market rates of pay for such experts in the pension industry, but by the Ontario Public Service. Without adequate numbers of experienced professional personnel, it is very difficult for FSCO to maintain proper levels of service under existing law; it will be even more difficult for the proposed OPR to assume a more ambitious and proactive role in overseeing the pension system, as I have recommended.

FSCO — or its proposed successor, the OPR — ought to be able to raise the funds it needs to perform the important tasks assigned to it at a high level of expertise and efficiency. Since, as noted earlier, FSCO operates on a user-pay or cost-recovery basis, it should be able to modestly increase the levies it imposes on plans in order to provide itself with a budget adequate for all of its ongoing functions, and to charge additional user fees for specific resource-intensive regulatory interventions — approving plan transactions, for example — now performed free of charge. Where levies and fees vary with the type of regulatory oversight and intervention required, they should be transparent, and the fee implications of regulatory intervention and oversight should be predictable for participants. As is the case with the Ontario Securities Commission, the OPR should negotiate a multi-year financial plan with the Ministry of Finance, and the Lieutenant Governor in Council should approve its proposed schedule of levies and fees.

> **Recommendation 7-22** — The Ontario Pension Regulator should have greater control over its budget and hiring practices so that it can recruit, train and retain the professional and expert staff it needs to discharge its enhanced regulatory functions. With the approval of the Lieutenant Governor in Council, the Regulator should be able to fix levies on plans according to plan size or type, to charge user fees for particular regulatory transactions and to retain for its own purposes administrative fines levied by the new Pension Tribunal of Ontario.

I am optimistic that improved service levels for sponsors and enhanced capacity to protect the interests of active and retired members will, over time, convince the pension community that some increase in the charges they pay was justified.

By contrast, however, if FSCO is required to collect and analyse data to support policy development by another agency — the Ministry or the proposed Pension Champion — it is reasonable that the recipients and prime users of that data should pay for its collection.

> **Recommendation 7-23** — The Ministry of Finance should supplement the budget of the Ontario Pension Regulator to enable it to perform functions such as data collection and analysis, which support policy-making and other non-regulatory functions.

7.4.4 A risk-based approach to regulation

A fundamental premise of any regulatory strategy is that available resources will never be sufficient to accomplish all of the oversight functions that must be performed. The most obvious way of using scarce resources to best effect is to deploy them to deal with the most imminent risks, or those that have the greatest potential to do harm. This approach, which is designed to achieve the highest regulatory impact for any given investment of resources, requires a regulator to be proactive — to intervene with a view to preventing adverse outcomes before they occur. It also requires that the regulator have the capacity to detect and assess the existence of threats as well as their relative intensity. By definition, it also prioritizes some activities over others so that, from time to time, some sectors, regulatees or issues receive more scrutiny, and others less.

In 2000, FSCO adopted just such a risk-based approach to some of its regulatory activities. In particular, FSCO has been developing risk-based regulatory systems in two areas: the funding of pension plans and their investment profile. An assessment of plan funding relies primarily on the filing of its AIS (described above and in more detail in Chapter Four). The AIS updates key data found in the triennial actuarial valuation, including contributions and actuarial assumptions, and enables FSCO to monitor the plan's funded status — a potential indicator of a plan's health. Plan investments are monitored through annual IISs, which provide standardized data concerning compliance with the federal investment rules, use of particular types of investments and changes in asset mixes. Both of these assessment techniques are used to identify plans at risk, which then attract further scrutiny by FSCO staff.

This approach to regulation depends in significant measure on the development of risk-assessment techniques, particularly quantitative and probability-based measurements. However, FSCO's implementation of its risk-based program has been uneven. First, FSCO's capacity to develop and apply risk-assessment protocols is hindered by its limited resources, especially of highly skilled staff and the means to pay them what they can command in other jobs. Second, risk assessment depends on FSCO's capacity to collect and filter large quantities of data supplied by plans, which, in turn, must be subject to appropriate controls to ensure compliance with the risk-assessment models developed by the regulator. And third, plans themselves must develop a commitment to and a capacity for risk assessment. This ought to be relatively easy for large plans, many of which already routinely conduct their own risk assessments. However, FSCO does not seem to have conducted any dialogue with these plans concerning the introduction of new risk-assessment tools and the promotion of standard risk-assessment methods, nor does it appear to have explored whether, and if so, how, to facilitate risk assessment by smaller plans, many of which do not now collect the data necessary to perform this function. In general, much more needs to be done before Ontario's system of pension regulation can be said to be truly risk-based.

I also note that FSCO has not yet developed the use of two further "risk indicators:" the credit-worthiness of plan sponsors (now used in the United Kingdom), and plan size, which research suggests affects plan performance across a range of performance indicators. Both of these risk factors are the subject of recommendations elsewhere in this report. Nor does FSCO conduct research into industry conditions or the business of specific types of sponsors except in an *ad hoc* and reactive manner.

Of course, risk-based regulation is itself not without risk. The focus on some regulatees deflects attention away from others deemed less likely to present a risk — an assumption that, from time to time, may turn out to be unjustified. Similarly excessive reliance on quantitative information can cause a regulator to undervalue other forms of risk assessment, such as field visits and proactive plan audits, either randomly or in response to rumours or complaints, and the close monitoring of economic conditions in financial markets or in particular sectors — say steel or auto — in order to anticipate their impact on plans.

In Recommendation 7-11, I propose that the pension regulator be better equipped to engage more actively and effectively in risk-based regulation. In the present context, I wish to emphasize that at the same time, the regulator should guard against possible limitations of risk-based regulation by more rigorous self-examination and more frequent engagement with its clientele.

> **Recommendation 7-24** — The pension regulator should facilitate the introduction of a program of enhanced risk-based regulation by consulting closely with stakeholder groups concerning the collection and analysis of standard data on which risk assessment can be based, and it should subject its own risk-assessment systems to rigorous self-evaluation and to critical comment by stakeholders.

7.4.5 Rules and rule-making

A number of submissions received by the Commission proposed that the regulator should have rule-making authority similar to that enjoyed by the OSC.

Confronted with changing economic conditions and new pension designs, the regulator essentially has two options. The first is to pursue its objectives pragmatically on a file-by-file basis, using the language of the statute and the regulations enacted under it. This is often feasible and, indeed, desirable in the early stages of any new regulatory regime. The second — attractive especially after the regulator has gained some experience with a new set of issues — is to codify its approach in the form of rules for the guidance of its clientele and as a way of systematizing its own previous *ad hoc* approach. When stakeholders are afforded an opportunity to comment on proposed new regulatory norms — as I propose — this second approach helps to ensure that these norms are informed by stakeholder experiences and perspectives, and that stakeholders feel some sense of commitment to the new arrangements they have helped to shape.

The advantages of this approach are clear. The pension field is complex and is changing rapidly. If my recommendations are accepted, it may well become even more complex and change even more rapidly. Ideally, new complexities will be captured by amendments to the PBA and those amendments will be enacted as rapidly as required by the pace of change. However, the legislative mill grinds slowly, and in the case of pensions, almost always controversially and, for that reason, at infrequent intervals. Even regulations enacted by the Lieutenant Governor in Council under the authority of the PBA tend to lag the need for their enactment. Thus, a desirable approach is one that makes it easier for regulatees to plan their affairs (and for regulators to oversee them) with some degree of certainty about what will be acceptable and what will not. General principles contained in a statute or a regulation may be too vague to provide that certainty, which, however, may be provided by supplementary or explanatory rules that define terms, establish bright-line tests or set out standard operating procedures. (Of course, rules may not contradict or derogate from the provisions of a statute or regulation — only lend those provisions greater specificity and predictability.)

There are, of course, some potential disadvantages to this approach. The development of a thicker set of rules may compromise the flexibility of simpler, principles-based case-by-case decision-making. Further, there is some risk that stakeholder participation in rule-making will lead to "regulatory capture" — undue influence by the stakeholders over both the content of the rules and the mindset of the regulator. And finally, there is a risk that the legal status and effect of these rules may be challenged. To an extent, however, forewarned is forearmed. If the regulator is self-critical, it can retain discretion and flexibility in the context of individual cases while still laying down the general parameters within which these cases are to be decided.

If it invites participation in rule-making by a broad range of stakeholders, it can reduce the chance that any one group will dominate the process. And if care is taken to authorize the making of rules by clear language in the PBA, the risk of legal challenges can be minimized or eliminated.

On balance, I believe that it would be best both for the regulator and for stakeholders that the OPR should be given, and should use, the power to make rules.

> **Recommendation 7-25** — The new Ontario Pension Regulator should have power to make rules in order to define and lend greater specificity and clarity to its governing statute and regulations. It should exercise this power only after giving stakeholders notice of, and an opportunity to comment on, proposed rules. Rules adopted pursuant to the use of this power should have the force of law so long as they are made in accordance with the statute and regulations and do not purport to contradict or derogate from them.

7.5 Adjudication and Appeals

As noted in section 7.3, the Superintendent engages in many different forms of regulatory oversight. Some of these are relatively passive and routine; others involve more active forms of decision-making; some — especially if my recommendations are adopted — amount to formal adjudication. But the Superintendent is not the only decision-maker. Unless he or she is to have both the first and last word in all matters relating to pension regulation, a second body must be established before which decisions of the Superintendent can be challenged, at least in important cases.

Two options are available. The first is to design a special appeals forum for pension matters; the second is to permit challenges to the Superintendent's actions or decisions to be heard in the regular courts. These alternatives are not mutually exclusive. Even if a special pensions appeals process is established, it is possible to permit appeals from that process to a court of general jurisdiction, which would have the power to overturn the administrative decision if it is "wrong," and to substitute another in its place. And even if no such appeals process is established, a dissatisfied litigant may nonetheless seek "judicial review" of a decision by the Superintendent or the special pensions appeals body — a more limited process that confines the reviewing court to overturning the previous decision only if serious errors are found, and to returning the matter to the administrative decision-maker for further consideration. Indeed, under our constitution, it is not possible to fully insulate administrative decision-making from both appeal and review.

Under the PBA, decisions of the Superintendent can be appealed to a special tribunal, the FST, which, as noted above, hears both pension appeals and those arising in other regulatory domains under the jurisdiction of FSCO. This arrangement differs somewhat from that which existed prior to the establishment of FSCO when pension regulation was assigned to the PCO. However, under the present arrangements — as under the PCO — decisions of the ultimate administrative decision-maker may be appealed to the Divisional Court, a special panel of the Ontario Court of Justice that deals with administrative law issues.

The FST is staffed by part-time panel members who are experts in their fields, as were the members of the PCO. Since its establishment in 1997, the FST has handled some 114 pension appeals from the

Superintendent (40% of its overall caseload) of which 21 are still pending. Approximately 60 were settled and 33 were decided on their merits. Eleven of those decisions were appealed to the Divisional Court, nine of which were actually heard. The Divisional Court originally affirmed five FST decisions and reversed four — but after further appeals, two of the nine challenged decisions were affirmed, for a total of two reversals out of nine challenges.

Some stakeholders argued in briefs and submissions that these two reversals —compared with none for the PCO — signalled a trend to diminished judicial deference for FST decisions. This trend, they maintained, was attributable to either or both of the changes in the regulator's "purpose clause" (discussed above), and the perceived dilution of FSCO's and FST's pension expertise since these bodies acquired regulatory responsibilities for non-pension matters in 1997. This may indeed be so, but nine appeals is too slight a foundation for such an important conclusion. Nor is it possible to evaluate this conclusion on its merits without considering the issues and circumstances of each case. The most that can be said is that — all things being equal — courts hearing appeals and applications for judicial review tend to be most deferential to administrative decision-makers when the latter are deciding issues whose resolution requires expertise, which they possess and courts do not.

Opinions concerning the FST, its functions and organization differed considerably. Some stakeholders noted particularly that its dependence on part-time panel members detracted from its ability to handle difficult issues. Moreover, since many of the part-time members with pension experience and expertise remained actively involved as advocates for, or advisors to, pension stakeholders, their impartiality was suspect. They might be replaced by members with no such affiliations, but this would detract from the overall pension expertise of the hearing panel. In addition, though the FST's caseload is very light — a dozen hearings a year — I was told that the frequent disqualification of members for actual or perceived conflicts of interest made scheduling difficult and interfered with the prompt dispatch of its business. Whether for these or other reasons, a view seems to have developed within the ranks of pension lawyers that whatever the FST might decide, cases of any consequence would be appealed as a matter of course to the Divisional Court.

Nor were these the only complaints. Researchers noted that a considerable number of cases involved litigants without legal representation (a point addressed above). They also noted that the FST was not fully independent of FSCO, given that the Superintendent — whose decisions were challenged before the FST — was also the chief executive officer of FSCO, and that FSCO controlled the FST's budget.

If the point of having a dedicated pension tribunal is to ensure that the regulator's decisions are subject to arm's-length scrutiny, to bring specialized expertise to bear on the issues, and to resolve them speedily and with finality, the FST is not — in the opinion of many — the answer. Nor, it seems, is the answer an enhanced role for the courts, as suggested by others. Stakeholders repeatedly (though not unanimously) told me that judges lacked expertise in the pension system and often failed to appreciate the impact of their decisions upon it. The pension system, they argued, is too complex for judges who encounter it for the first time in the course of a trial or appeal (as most do) to develop a sophisticated understanding of it. Such understanding requires a significant knowledge of the history, economics and politics of pensions, while comprehension of pension law requires the mastery of not only a significant body of technical statutory and common law but of the actuarial and accounting practices that inform and give point to the legal rules. Of course, one or more judges may have acquired expertise in pension matters prior to being appointed to the bench. However, there is no guarantee that judges with such expertise will be available to sit on pension appeals or judicial review applications or, for that matter, on civil cases involving pension disputes. Indeed, the odds are strong that a judge who hears any given pension case will not be familiar with the field.

That is why, on balance, I am persuaded that a specialized pension tribunal is better placed than a court to comprehend the practical consequences of its decisions, to use its knowledge of the system to evaluate changing patterns of behaviour by both stakeholders and the regulator, to make itself accessible to individuals affected by the system, and to provide consistent interpretations of pension law that will provide sensible guidance to litigants and to the pension community in general. My conclusions in this regard rest on my familiarity with the general literature on regulation, on some knowledge of the successful experience of tribunals in pension-related fields such as securities regulation and labour relations, and on what I have heard concerning the success of the former PCO. I therefore conclude that re-engineering the FST to overcome its perceived deficiencies is a more promising option than enlarging the role of courts in the regulatory process.

The task of re-engineering the FST begins with the observation that I have already recommended: that pension law be codified to the maximum extent possible. If this is achieved, and if other recommended reforms in the Superintendent's jurisdiction, responsibilities and powers are instituted, I anticipate that the caseload of the appeals tribunal may grow somewhat. Second, if my recommendation for a free-standing single-purpose pension regulator — a new Ontario Pension Regulator — is accepted, it follows that the FST should be reconstituted as a stand-alone Pension Tribunal of Ontario (PTO) shorn of its responsibilities for other matters now under FSCO's jurisdiction. It follows, as well, that all members appointed to the new tribunal should possess expertise in pensions or some closely related field. These steps should ensure both that the PTO is, in fact, an expert tribunal, and that it is perceived as such by reviewing or appellate courts and by the pension community.

> **Recommendation 7-26** — The pension jurisdiction of the Financial Services Tribunal should be transferred to a new Pension Tribunal of Ontario. The Tribunal should have power to hear and decide specified matters at first instance, and to hear and decide all appeals from orders made by the Superintendent.

The next issue that must be addressed is that of the membership of the proposed PTO. To reassure those who favour court determination of pension issues, the PTO ought to be led by a jurist of stature with considerable pension experience — a highly respected individual with legal training, such as a judge, lawyer, legal academic or former regulator. To avoid any possibility of a conflict or perceived conflict of interest, that person — the Chair of the PTO — ought either to be retired from their former position or to be employed part-time in some non-adversarial capacity (for example, as a member of a tribunal outside the pension field or as a mediator). Whether their service on the PTO is full-time or part-time will depend on how the caseload of the PTO develops. If the caseload grows considerably, a Vice-Chair with comparable credentials ought to be appointed. Currently, the FST comprises some 13 members, all part-time. I believe that a much smaller tribunal would resolve many of the scheduling and other difficulties associated with the present model. At the same time, the new PTO must be large enough to number among its members experts in both pension law and actuarial science — the two principal bodies of learning that ought to inform its decisions. However, in acknowledgement of the fact that a number of individuals have acquired great pension expertise without formal training or credentials in law or actuarial science, such credentials should not be a prerequisite for membership of the PTO. PTO members should, like the Chair, either be retired or employed part-time in some non-adversarial capacity, but not in the pension field.

Many individuals eligible for appointment as either Chair or members of the PTO will likely have a background in advising either sponsor- or member-side clients. To ensure that the PTO is, and is perceived to be, neutral and balanced as between sponsor and member perspectives, all appointments should be vetted by a bipartisan nominating committee. The committee may identify as members individuals who are highly respected and trusted as neutrals in the pension community despite their partisan background, or may seek balance within the PTO by nominating equal numbers of members with acknowledged partisan backgrounds that will offset each other. As the reputation and effectiveness of the PTO depend on the trust it enjoys among stakeholders, it is essential that the nominating committee propose for appointment only individuals of considerable ability. It is equally essential that the Lieutenant Governor in Council, in making appointments, should respect the advice of the nominating committee.

> **Recommendation 7-27** — The Pension Tribunal of Ontario should comprise a Chair who is a jurist of stature, two members with a background in law (or equivalent), and two members with a background in actuarial science (or equivalent). Appointments to the Tribunal should be recommended by a bipartisan nominating committee with a view to ensuring that the Tribunal enjoys the confidence of both sponsor-side and member-side stakeholders and is perceived to be balanced and neutral.
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> The Chair and members of the Tribunal should be allowed to serve part-time, but not to hold concurrent employment that might involve, or be seen to involve, them in a conflict of interest. All members of the Tribunal should possess expertise in pensions or some closely related field.

In order to address the scheduling problems presently encountered by the FST, the Chair of the PTO should be permitted some degree of flexibility in assigning panel members.

> **Recommendation 7-28** — The Chair of the Pension Tribunal of Ontario should be allowed to sit alone to hear and decide cases relating to specific provisions, such as the enforcement of orders made by the Superintendent. In more complex matters that may require specialized actuarial or legal knowledge, the Chair may designate the two members with backgrounds in those fields to serve on a hearing panel. If in the opinion of the Chair both types of knowledge are required, all four members may be designated to serve.

Given its mandate and the reasons for its creation, the PTO should possess plenary powers to dispose of all cases before it. It should be able to dispose not only of applications to enforce orders of the Superintendent and appeals against such orders, but also all ancillary questions that might arise in the context of administering the PBA, such as the meaning and effect of plan documents. If experience demonstrates that some form of mediation might assist the parties more than formal adjudication of their differences, the PTO might appoint staff or, with certain safeguards, tribunal members.

Recommendation 7-29 — The Pension Tribunal of Ontario ought to have all powers necessary to dispose of matters before it.

During the Commission's hearings, I was advised of several instances where pension issues arose for decisions in other forums, especially before the Ontario Labour Relations Board or labour arbitrators. While acknowledging that such bodies can assert jurisdiction over pension matters under present law, in the interests of ensuring that pension disputes are resolved in a consistent fashion by the tribunals best qualified to decide them, I believe that the law ought to be changed.

Likewise, an open-ended right of appeal to the courts would undo many of the positive effects of the new PTO. At the very least, it would tempt deep-pocketed litigants who are dissatisfied with its decisions to continue litigation to higher levels where their less-well-off opponents would be at a disadvantage. At worst, it would protract proceedings, expose them to the risk of disposition by non-expert judges, and diminish the chances that the PTO will be able to maintain the coherence and consistency of pension law — which is the objective of my recommendation that the law in this area should be codified.

Of course, any attempt to totally preclude review or appeal would likely fail on constitutional grounds — nor should egregious error by the Superintendent or the PTO be allowed to go uncorrected.

Recommendation 7-30 — The Pension Tribunal of Ontario should exercise exclusive and ultimate jurisdiction over all matters arising out of or incidental to the interpretation of the *Pension Benefits Act*. Decisions of the Tribunal should be final and binding, subject to appeal to the Divisional Court only if they involve a denial of natural justice, a misinterpretation of the applicable law so serious as to amount to jurisdictional error, or a violation of the constitutional rights of a party.

It is my hope and expectation that if these recommendations are implemented, over time the PTO will earn and enjoy the respect of the pension community; that it will become the sole source of authoritative interpretations of pension law; that it will develop a body of well-reasoned decisions for the guidance of the regulator and the stakeholders; and that it will be able to provide all parties with one-stop accessible, speedy, expert pension adjudication. This will surely constitute a significant contribution to the overall health of the pension system.

In previous chapters, I noted the need for the pension regulator to have recourse to a full array of remedial powers. In part, this reflects my belief that prosecution is often not an effective avenue of recourse — even when linked (as it now is) to the power of a convicting court to order various forms of monetary compensation to be paid to the plan. The criminal burden of proof is too high; judges are reputedly reluctant to convict in white-collar offences; and criminal courts lack expertise in pension matters. It would be far preferable, in my view, to equip the PTO with an appropriate array of remedial powers, leaving court prosecutions for the most extreme cases where there is a need to punish the offender and deter others, as well as to remedy the offence. These additional powers would complement the power of the PTO to enforce — as well as hear appeals from — orders made by the Superintendent.

Recommendation 7-31 — The Tribunal should have plenary power, upon enforcing or hearing an appeal from any order made by the Superintendent, to make any order required to secure compliance with the *Pension Benefits Act*, including but without limiting its general power, the power to:

- require the doing of any act required by the statute and the cessation of any act forbidden by it;
- order the payment of contributions, benefits or premiums wrongly withheld, together with interest thereon;
- require the disclosure of information and the provision of documents to the regulator, active and retired plan members, unions and representative organizations and others entitled to such information or documents; and
- impose administrative fines for non-compliance with the *Pension Benefits Act*.

Any order of the Tribunal may be registered in the Ontario Court of Justice and enforced as an order of that Court.

CHAPTER EIGHT – GOVERNANCE

8.1 Introduction

Our pension system rests on the premise that the sponsor — typically a single employer — bears most, if not all, of the risks associated with the pension promise. This assumption logically entails the conclusion that the sponsor alone should control plan governance. But unilateral sponsor governance produces its own further conclusion: that the state should regulate the governance process in order to protect members from possible abuses of power by the sponsor. In recent years, however, the centre of gravity in the debate over risk-bearing has shifted. It is now widely — though not universally — accepted that plan members bear some risks as well, whether because they have forgone wages, made matching contributions or stand to lose if the plan falters or fails. The dominant model of unilateral sponsor governance has shifted as well. Some 60% of all plan members and 70% of defined benefit (DB) plan members are now enrolled in plans in which their representatives participate in or control the governance process. Accordingly, it is time to consider whether the main thrust of state regulation should shift, too — from preventing the sponsor's abuse of power to ensuring that governance is conducted openly, honestly and competently.

That said, some 30% to 40% of plan members are still enrolled in single-employer pension plans (SEPPs), most of these plans are governed by the sponsor, the "old" governance issues persist, and so does the need to better understand the dynamic relationship — the synergy — between governance and regulation. In the next section I explore this synergy; in the section following, specific governance issues common to all plans; and in a concluding section, new or enhanced governance models, which provide for the participation of representatives of active and retired plan members.

8.2 The Synergy between Regulation and Governance

8.2.1 Single-employer pension plans

My discussions with stakeholders have left me with the impression that some SEPP sponsors and unions have not yet engaged constructively with governance issues. For the stakeholders, the "bottom line" is whether the pension promise will be kept — not by what means or process or with whose knowledge, consent or participation. This focus is perhaps understandable. Both employers and unions are struggling with difficult economic challenges. They see the investment of precious time and scarce resources in better plan governance as a distraction from their core preoccupations — a distraction, moreover, that in their view is unlikely to produce meaningful or positive outcomes. But failure to address governance issues may, in the end, not only disserve labour and management but derogate from the achievement of regulatory objectives.

Plan failures, for example, are often and fairly characterized as sponsor failures, and sometimes as regulatory failures. But they could equally be described as governance failures. If governance were more transparent and participatory, if member representatives were made aware of and given some voice in decisions about contributions, investments and benefit structures — and assumed a share of responsibility for the outcomes of those decisions — they might suggest approaches that would avert disaster, alert the regulator if a need for intervention should arise, or devise least-worst outcomes for their members and retirees. Greater transparency, even in employer-administered plans where no union is present, might have the same positive consequences as in other consumer contexts: members would become alert to the dangers, could seek timely assistance from a lawyer or the regulator or begin to rearrange their affairs.

Sponsors, too, would profit from improved governance practices. For example, best-practice benchmarking would enable pension plans to evaluate their own practices against those of pension plans across the system. This is hardly a novel suggestion. Benchmarking is a legitimate, well-tested and widely used aid to decision-making in other domains of corporate governance, but in the pension world is confined to a narrow range of issues and remains a largely private exercise — a service offered by consulting groups to their clients. It is not employed to its full potential as it could be if undertaken by the regulator with data collected and made publicly available across the pension system. Thus, SEPPs would be encouraged to compare themselves not only with larger or smaller counterpart plans, but also with multi-employer plans (MEPPs) or with jointly sponsored pension plans (JSPPs) in relation to investment management expense ratios, asset selection and returns, administrative costs, levels of service to members and retirees and other indicators of plan performance. Such comparisons might prompt a given SEPP sponsor to consider a change in plan design, investment strategy or service providers with a view to improving returns, reducing the costs of administration, lowering its contributions or improving benefits.

For benchmarking to work well, standard data must be collected not just from plans that choose to participate, but from all plans; and it must be analysed by competent and disinterested experts. While private consultants can and do provide useful benchmarking services, it would be much more efficient for the regulator to undertake regular and comprehensive benchmarking to a greater extent than it does now. Once the regulator uses the data (much of which it already collects) to develop and deploy benchmarks, a new dynamic comes into play. The regulator is now in a position to "nudge" sponsors into improving their approach to plan governance. Senior corporate managers, many of whom are not directly involved in plan governance, may be prompted to take a greater interest in the plan in order to ensure that plan administrators are developing strategies to improve their performance ratings. The company's directors and shareholders may also become engaged with governance as well as funding issues; if a plan is underperforming, they can ask management awkward questions and insist on a new approach. And plan members (and their union, if any) might become, as suggested, informed and empowered "consumers" who can raise objections and make suggestions either within formal governance structures if they are represented there, or outside them if they are not.

To sum up: more transparent plan governance can lead to better plan performance. The regulator's contribution to better governance is to ensure transparency, to provide expert analysis and to make the benefits of both available to stakeholders. The contribution of both professional and representative actors in the governance process is to ensure that they take advantage of transparency to secure better pension outcomes.

> **Recommendation 8-1** — The regulator should establish benchmarks or performance indicators covering the broadest possible range of governance issues, including funding, benefits, expense ratios, administrative costs and service to members and retirees. Plan administrators should provide, and the regulator should collect and analyse, data relevant to these indicators.
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> The results of this exercise should be made publicly available so that sponsors, administrators and beneficiaries can evaluate the performance of their plans as against the performance of specific comparator groups and of the whole system.

The role of unions in plan governance is a closely related issue. Unions have bargaining relationships with sponsors whose workers comprise some 70% of all plan members and 80% of DB members (but only about one in three SEPP members). In many workplaces they have been instrumental either in persuading employers to establish a pension plan or in embedding previously established plans in their collective bargaining agreement. In either case, through collective bargaining, unions have the opportunity to influence various aspects of the plan, including its design, funding and benefits.

However, the adversarial, one-minute-to-midnight atmosphere of collective negotiations is sub-optimal for working through complex, technical pension issues that often require lengthy time horizons for their resolution. Indeed — as some stakeholders reported — pension decisions taken at the bargaining table are sometimes made with little or no information about the plan. Moreover, the plan itself is not represented in the negotiations, so there is a risk that pension concerns may be set aside by the principal parties if seen as impeding the settlement of more immediate, comprehensible and controversial issues.

While issues relating to overall pension costs must be dealt with in the context of comprehensive collective negotiations, some technical or administrative pension issues could sensibly be taken off the table and remitted to the body responsible for plan governance, where labour and management representatives can examine them with greater care, better information and less pressure. But what if there are no union or member representatives on the plan's governing body? Under Ontario labour law, employers are under a duty to bargain in good faith concerning any matter that a union chooses to place on its negotiating agenda — including the governance of a pension plan. If negotiations fail to produce agreement, the union may strike to achieve its goals. Thus, unions have available the means for securing a greater role for themselves in the governance of pension plans — if they care to use it. In some contexts, especially in the public sector, employers have agreed to involve member or union representatives directly in governance. For example, JSPPs — all in the public sector — are by definition committed to a model of shared governance; by contrast, university SEPPs, in the broader public sector, are generally administered by the governing body of each institution, with member or union representation, if any, confined to committees. In the private sector, shared governance arrangements vary considerably. At one extreme — in construction sector MEPPs, for example — employers have ceded complete control of the governance process to unions. At the other — in a large number of SEPPs involving, however, a distinct minority of unionized plan members — union or employee representatives still play no formal role at all in decision-making.

There are many possible explanations for this situation. Employers may adamantly insist on maintaining unilateral control of the plan; unions may lack the bargaining power to back up their demands for a share in plan governance; and constituencies within the union may insist that it address pension issues other than governance. However, I have the impression that a significant number of unions and union decision-makers simply do not want to get involved in governing pension plans. That is their decision, of course, but the consequence is that the regulatory process may sometimes be called upon to resolve issues that otherwise could have been resolved through plan governance procedures in which workers would have an effective voice.

This is not to say that all decisions arrived at through collective bargaining — or through joint governance structures based on collective bargaining — will inevitably arrive at the right balance among benefit security, affordability for the sponsor, and pensions that are adequate for retirees.

For example, flat benefit plans — widespread in the manufacturing and mining sectors — are typically employer-administered SEPPs, often established under collective agreements. Contributions are a fixed sum per hour worked; and benefits are a fixed or flat monthly sum per year of service. Since benefit levels are often revised upwards in tandem with increased wages, significant commitments for the past service of present plan members are added to the plan's liabilities in each round of bargaining. The result, according to FSCO data, is that flat benefit plans have the lowest median solvency funding ratio of any type of plan and, for that reason, one might infer, they attract (or should attract) a disproportionate amount of regulatory attention. In my mind, this raises three questions. If union or member representatives were more often involved in the administration of these plans, would they come to better understand their inherent limitations? If they were to accept a greater share of responsibility for governance decisions, would they make greater efforts to ensure that plans were better funded? Should the regulator continue to be responsible for ensuring that plans are adequately funded if the parties have neglected to do so?

Another example: unions are legally entitled to negotiate on behalf of all workers in the bargaining unit, but not former unit members who are now retired. Of course, some unions feel their responsibilities to retirees keenly, and make efforts to protect retirees' interests by seeking inflation protection and other improvements. On the other hand, as democratic institutions, unions must ultimately pursue the goals favoured by their current, voting members — who in most unions do not include retirees. Unfortunately, at times the interests of retirees and current members clash. For example, should the union bargain for — and strike for — higher wages for active plan members or indexation for retirees? Since retirees are denied a voice and vote in most unions, they have little opportunity to influence the union's position. The obvious questions: Who is responsible for ensuring that retirees are treated fairly? The union? The sponsor? The regulator? Those responsible for plan governance? Principles of good governance require that the interests of all classes of plan members be considered. Hence, the final question: Should retirees not have the right to a role in governance so that they can speak on their own behalf?

In the end, the issue is whether decisions taken by plans with representative governing structures, reinforced by and embedded in properly functioning collective bargaining relationships, should be allowed a larger margin of discretion by the regulator than plans that lack such structures. Within limits, I am generally sympathetic to this position. Elsewhere in this report, I indicate how this might be accomplished.

> **Recommendation 8-2** — Unions should be encouraged to negotiate both the major substantive elements of pension plans arising out of collective agreements and the governing structures of such plans. The regulator should accord plans with joint governing structures a greater margin of regulatory discretion than would be available to plans lacking such structures.

As a corollary, unions should prepare themselves to discharge these important governance functions in a responsible manner and at a high level of competence.

> **Recommendation 8-3** — Unions that seek and accept a role in plan governance should be encouraged to ensure that both active and retired members have a voice in decisions that affect them. Unions should also develop the technical and analytical capacities necessary to support effective member participation in plan governance.

This latter requirement may well prompt collective or cooperative efforts by unions, perhaps in the form of a province-wide union-affiliated "pension centre," which could undertake research, provide expert advice to individual unions and perhaps train staff and educate members. Such an effort might in turn lead to a consolidation of small, single-employer plans, for reasons and in ways that are discussed in Chapter Nine. If so, regulatory objectives will have been advanced by the adoption of improved governance arrangements.

Finally, in the two-thirds of SEPPs that are not unionized, and in which member participation in governance is difficult to implement and less likely to occur, the regulator will have to continue to monitor the sponsor's administration of the plan with appropriate vigilance. A number of suggestions in this regard appear below.

8.2.2 Multi-employer and jointly sponsored pension plans

MEPPs and JSPPs both begin from the same point of departure: plan members bear significant risks and should therefore have a considerable say in the governance of their pension plan. As noted in Chapter Four, these governance arrangements have been instituted in parallel with provisions relating to funding and/or benefits, which differ from those of SEPPs.

MEPPs are funded by a standard contribution per hour worked for each participating employer (and sometimes by member contributions as well); contributions and service credits are consolidated in order to calculate the member's pension entitlement. In the event that the plan has insufficient funds to pay members their accrued or promised benefits in full, benefits may be adjusted both prospectively and retrospectively. This last feature — which involves a clear shift of risk from sponsors to members — is crucial. Its logical corollary is that both active and retired members should have the right to participate through their representatives in making decisions about benefit reduction, as well as other governance decisions.

The *Pension Benefits Act* (PBA) requires that member representatives must constitute at least 50% of the body charged with governing the plan. However, in fact, many MEPPs are governed entirely by member representatives — typically appointees of the union that negotiated the plan. Unilateral control, of course, leaves MEPPs open to possible abuses of power similar to those that were seen to justify a high degree of regulatory vigilance in the case of sponsor-administered SEPPs. Where SEPPs may run the risk of confusing plan interests and employer or corporate interests, MEPPs may run the risk of confusing union interests with plan interests. In the construction industry, for example, some plans may be tempted to invest their funds in real estate development or infrastructure projects that generate employment opportunities for construction workers. The appropriate parameters of MEPP investment policy thus become a matter for regulatory concern for reasons similar to those that justify the prohibition on SEPPs investing in the sponsor's business.

True, the parallels are not perfect. The trustees of union-administered MEPPs would be acting to protect the collective interests of plan members rather than those of another group — the sponsor's shareholders. And in principle, if not always in practice, unionized workers have the right to hold their pension trustees accountable through the political processes of the union. Nonetheless, without a system of checks and balances being built into MEPP governance, the risk of abuse remains. Regulation can help to supply checks by encouraging or requiring MEPP trustees to keep members fully informed and providing opportunities for them to discuss and make key plan decisions. And they can provide balance in MEPPs by ensuring that representatives of beneficiaries other than active plan members also have a voice in plan governance. I have in mind particularly retirees whose vital interests may be adversely affected if pensions in pay are reduced by a member-only board of trustees in order to preserve the benefits of active members.

Finally, during the course of the Commission's hearings, I heard allegations — unsubstantiated allegations, I must stress — that some MEPP trustees were receiving inappropriate perquisites of office, or using their office for personal gain. Since some MEPPs may not be subject to the same internal audit procedures and financial controls as most corporations and sponsor-administered SEPPs, such abuses are at least conceivable. It is important that if they are actually occurring, they should be brought to light and stopped. One way to stop them is to address their root cause: some MEPP trustees who serve as volunteers (some are paid salaries as union officers or staff members) may believe that they are entitled to perquisites in lieu of remuneration. It would be more transparent and conducive to accountability to provide trustees with appropriate and modest remuneration in an amount set openly by the board of trustees and reported as part of the plan's financial statements.

All of these concerns present the same policy dilemma: should they be resolved by detailed legislation, or should MEPP and JSPP governing bodies themselves be encouraged or required to resolve them? As I suggest later in this chapter, in my discussion of the conflict of interest issues confronting SEPPs, the answer is probably a combination of both.

> **Recommendation 8-4** — Multi-employer and jointly sponsored pension plans should develop governance policies that ensure participation of representatives of both active and retired members in their governance, establish the means of selection of those representatives, fix their remuneration and lay down rules governing their conduct in office.
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> **Recommendation 8-5** — Multi-employer and jointly sponsored pension plans should provide annual statements to all active, deferred and retired plan members, which include:
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> - a statement of the plan's current funded status;
> - a reminder that benefits provided under the plan are not defined or guaranteed but subject to reduction while the plan is ongoing (in the case of multi-employer plans) or on wind-up (in the case of jointly sponsored plans);
> - disclosure of any known events likely to lead to a reduction in benefits; and
> - an indication of any procedure or formula specified by law or in the plan documents by which benefit reduction may be determined.
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> **Recommendation 8-6** — Multi-employer and jointly sponsored plans should develop and abide by investment rules that prevent self-dealing either by the union that has negotiated them or by plan trustees.

Recommendation 8-7 — All policies, statements or reminders required by current law or provided by multi-employer and jointly sponsored plans pursuant to these recommendations should be communicated to plan members and beneficiaries and filed with the regulator. The regulator should have the power to sanction violations of both statutory requirements and plan policies.

JSPPs, which presently account for 35% of active DB plan members, represent a distinctive response to the proposition that the sharing of risks necessarily implies the sharing of governance responsibilities. As their name implies, the distinguishing feature of JSPPs is that both employers and workers must sponsor — "contribute" to — a DB plan, and both are "jointly responsible" for its governance. (However, while regulations specify that members must not contribute more than the employer, no minimum contribution is specified, and while members must be "jointly responsible" for governance, no specific governance structures are mandated.) The fact that all existing JSPPs are in the public sector or broader public sector, and all but one of them is a MEPP, reflects their historical origins — not the legal requirements for their establishment. In principle, any private sector MEPP or SEPP could become a JSPP by meeting the minimum conditions in the regulation, and any JSPP could choose to convert itself into a "pure" MEPP or a SEPP.

There are many attractions to JSPPs. For example, because the parties share responsibility for funding the plan, proposals to increase benefits require that both look carefully at how these will be paid for and whether they will be proposed for this purpose. Both parties also have an interest — a direct and considerable financial interest — in ensuring that governance decisions are taken on the basis of the best available information and professional advice. In short, the sharing of funding responsibilities may lead not only to the sharing of governance responsibilities, but also to improvements in the quality of governance decisions and, ultimately, in the funded status of plans. Finally, of course, the large size of JSPPs also contributes to their success, for reasons explored in Chapter Nine. The strategy of encouraging large plans (proposed in that chapter) may well lead to the creation of new JSPPs or the acquisition of new members and functions by existing ones.

If and when these plans become more numerous, extend into the private sector, and acquire even more members than at present, they too may reveal special governance problems that are not now obvious. For now, it is sufficient for me to suggest that JSPPs may be ideal candidates to test the proposition that enhancements in plan governance should make possible a relaxation of regulatory requirements.

8.3 Promoting Good Governance

8.3.1 The importance of good governance

Pension governance and administration require the making of difficult and sensitive decisions. In this section I propose to make the case that good governance enhances the chances of getting these decisions "right" and thereby contributes to the health of individual plans and the stability of the pension system as a whole. Conversely, if funding decisions are based on insufficient knowledge or information, and taken without due care for the interests of the plan and plan members, the result — as many studies have shown — is likely to be poor plan performance.

As I suggested in Chapter One in my enumeration of the principles underlying this report, good governance and good administration require that participants in administration should be prudent, honest, knowledgeable, efficient and successful.

8.3.2 The elements of good governance

The classical trust doctrines — which are adopted, codified and translated into contemporary language by the PBA — use "prudence" as a shorthand term to encompass all the other elements of good governance and administration. Accordingly, I will deal with "prudence" first.

Prudence

Prudence is a fundamental, indispensable characteristic required of anyone who assumes the responsibility of acting on behalf of another. The PBA states quite plainly that plan administrators are required to "exercise the care, due diligence and skill in the administration and investment of a pension fund that a person of ordinary prudence would in dealing with the property of another person."

Or perhaps too plainly. Administrators of Ontario's pension plans are no longer simply "persons of ordinary prudence," as perhaps they once were. Indeed, they are usually not persons at all, but rather large corporations whose "prudence" has been elevated to an altogether higher level by their ability to mobilize staff, consultants and advisors, to develop and deploy analytical systems, and to make full use of information sources to produce decisions that are wiser than "ordinary." That is why the PBA requires that they must use "all relevant knowledge and skill that the administrator possesses or, by reason of the administrator's profession, business or calling, ought to possess." And that is why administrators are specifically authorized to "employ one or more agents to carry out any act required … in the administration or investment of the fund" — and why agents are made subject to the same standards as the administrator that employs them.

Not only have the identities and capacities of plan administrators changed; so, too, have expectations within the pension community of the variety of investment or other decisions that might "prudently" be made. This has become evident in the debate over the quantitative investment rules adopted under the federal *Pension Benefits Standards Act* (PBSA).

In Chapter Four I recommended eliminating, modifying or replacing some of those rules, which restrict investment in certain Canadian companies but not those in their foreign counterparts. In this chapter, I focus especially on the so-called 30% rule, which inhibits the right of plan governing bodies and pension administrators to adopt an active investment strategy that includes the private placement of pension assets to acquire dominant positions in large enterprises in Canada and abroad. It is widely, if not universally, believed that only such a strategy will enable some plans to meet their obligations over the long term. If this is true, more conservative investment strategies may not be as "prudent" as more aggressive ones. However, administrators are presently prohibited from investing plan assets in the securities of any corporation in which they would control more than 30% of the voting shares. This restriction, if rigorously enforced, would place pension plans in the position of being unable to exercise influence over corporate decisions in the same way that other investors with comparable holdings routinely do. Consequently, some large, well-managed and presumably prudent pension plans routinely circumvent it.

I believe that under certain circumstances, plans should be able to claim exemption from the 30% rule. If plan members or their representatives are able to control the actions of the administrator through significant participation in plan governance, they should be allowed — within limits — to define the extent of risk they are prepared to tolerate. And if a plan administrator possesses the capacity to make complex and consequential investment decisions that require active rather than passive participation in corporate management, the scope of "prudence" should be expanded accordingly. Capacity, for reasons set out in Chapter Nine, is often related to plan size, access to expert staff, outside advisors and other resources.

To avoid any misunderstanding, the right to be relieved of the 30% rule should be available only to plans that meet both conditions — member participation and administrator capacity, as outlined above, appropriate to the kinds of investments contemplated. Which plans meet those conditions will have to be spelled out in greater detail in implementing regulations.

> **Recommendation 8-8** — Any plan with some recognized form of joint governance and with the requisite capacity to make complex investment decisions (as defined by regulations) should be allowed to adopt a resolution claiming an exemption from the 30% investment rule. The resolution should be filed with the pension regulator and have effect upon filing, unless and until it is successfully challenged.

Honesty

From time to time pension plans have been the victims of theft or fraud. Such conduct is so obviously wrong that it requires no detailed analysis. Plans and plan members should be protected against it; administrators, trustees or service providers who are guilty of such conduct should be removed from any connection with the plan and punished in accordance with the general law.

However, in the present context, "honesty" has a somewhat different connotation. Participants in the governance process have a duty to serve the plan with undivided loyalty; failure to do so can be described as not acting "honestly" toward the plan. Unfortunately, as I have gathered from many stakeholders, the roles of some key actors in pension governance are ambiguous so that their duty to the plan is not clearly defined. The result is that they routinely engage in conduct that an objective observer might regard as involving a conflict of interest. Such conflicts are best described as systemic or structural and generally do not involve any personal impropriety.

The best way to deal with these conflicts is, therefore, to improve the system of plan administration and redesign the structures that may distort it. This amounts to a suggestion that pension plan administration should be conducted at arm's length from the sponsor's business. I appreciate that making this a legal requirement might represent such a departure from the prevailing arrangements as to risk destabilizing the whole SEPP system. On the other hand, the experience of JSPPs, which exemplify the arm's-length approach, reminds us that free-standing plans can not only avoid conflicts of interest, but can become large, well-managed, focused in their concerns and highly successful. I develop this idea further in Chapter Nine.

Three systemic or structural conflicts attracted particular comment: the SEPP employer as both sponsor and administrator of the plan, the plan member/union official as trustee in a MEPP or JSPP, and the actuary as professional advisor to both the sponsor and the plan.

In many SEPPs, the employer acts as both sponsor and plan administrator. As sponsor, the employer has an obligation to maintain the plan only so long as, and to the extent that, the corporation's business interests are served and its legal obligations are discharged. Thus, the limits of the sponsor's duty are to contribute funds, as required by the PBA, sufficient to keep the pension promise. However, as administrator, the employer is an agent of the plan and thus owes it fiduciary duties, including the duty to ensure that it is as solvent as possible, that it receives high-quality, independent advice from professional advisors, and that the interests of plan members are protected to the maximum extent possible.

How might these duties conflict? For example, the administrator of a mature plan may accept that the best way to match its assets to its liabilities is to invest in low-yield, fixed-return, but very safe investments. However, to do so would be expensive and would require much higher contributions from the sponsor than an investment strategy that featured potentially high-yield but also high-risk equities. How can a plan administrator who is also a senior officer of the sponsor corporation make a choice — or, more likely, strike a balance — that does full justice both to the plan's interest in enhanced security and the sponsor's interest in keeping down costs? Another example: I mentioned in Chapter Four the difficulties sometimes encountered by chief financial officers in administering their company's pension plan in-house while continuing with their other demanding executive responsibilities. This is another instance of what I have called structural or systemic conflict of interest: the logic of corporate governance obliges them to attend to responsibilities that — according to the logic of plan governance — they are not appropriately positioned to perform.

Active plan members who serve as trustees of MEPPs or JSPPs face comparable contradictions. For example, if a JSPP is under-funded, a union-nominated trustee might sensibly recommend that contributions by both parties be increased — but this might run counter to the same individual's ambition as a union officer to persuade the company to raise wages or improve benefits at the next round of collective bargaining. Another example: in a MEPP, under-funding may require benefit reductions for active plan members, retired members or both. This places the trustee in the position of voting on whether his or her own benefits will be reduced or whether someone else should bear the pain.

To some extent these conflicts are unavoidable so long as member representatives sit on the plan's governing body. However, they can be mitigated in one of three ways. The first is to ensure that representatives with differing interests are appointed as trustees. Thus, the presence of retired members on MEPP boards and of employers on JSPP boards will, or should, ensure that systemic conflicts cancel each other out to some extent. The second is to appoint non-beneficiaries as trustees. These might include officials or retired officials from different unions, or practising or retired pension professionals. And the third is to pre-empt or lessen conflicts by adopting formulaic rules. For example, if MEPP plan documents were to require *pro rata* reduction of benefits for both retirees and active plan members, as I have proposed, the conflict need never arise.

Recommendation 8-9 — Plan sponsors who administer their own plan should be encouraged to reduce or eliminate inherent conflicts of interest by:

- ensuring, so far as possible, that those assigned to the role are given an unequivocal mandate to act in the best interests of the plan;
- providing representation for members and/or retirees and/or independent members on the plan's highest decision-making body; or
- retaining arm's-length professional advisors to administer the plan on their behalf.

Recommendation 8-10 — Plans that appoint active or retired members to serve on their governing bodies should be encouraged to resolve potential conflicts of interest in advance by:

- adopting clear policy statements in the plan documents;
- ensuring the significant representation on those bodies of groups with divergent interests; or
- appointing some trustees or governors unaffiliated with any group whose members are covered by the plan.

I appreciate that all of these recommendations represent a challenge to current governance practices in many plans. Nonetheless, versions of them are already adopted voluntarily by some plans in Canada and elsewhere, and in some jurisdictions. It seems sensible that plans be given an opportunity to experiment with the solutions that work best for them before these recommendations harden into requirements imposed by law.

Recommendation 8-11 — The Pension Champion, proposed in Recommendation 10-5, should work with stakeholders to identify approaches to the resolution of conflicts of interest appropriate to their particular circumstances.

The third instance of a possible conflict of interest — one mentioned frequently by stakeholders — relates to the role played by actuaries in the governance process. Actuaries may be engaged to advise both the employer/sponsor and the plan administrator. In this dual capacity actuaries may find themselves performing ambiguous, if not conflicting, roles. To which client is the actuary ultimately accountable? Is the point of a valuation to maximize plan security or to indicate to the sponsor how contributions can be kept to the absolute minimum permitted by law? Does the actuary provide advice or merely information to his or her clients?

Ambiguity and conflict are most often encountered in the course of performing actuarial valuations when the actuary has to take account of a range of variable or discretionary factors — especially the discount rate — thus providing a range of choices to the sponsor. The breadth of the options offered should be influenced by the actuarial firm's desire to serve both "clients," though many see one of those clients — the employer/sponsor — as having the greatest influence over the actuary.

Of course, the actuary's discretion — and hence potential exposure to conflict — is not infinite. Actuarial valuations must by law be conducted in accordance with professional standards set by the Canadian Institute of Actuaries (CIA) and adopted by reference under the PBA. Those standards are currently being revised by the CIA in ways that structure and confine actuarial discretion. And as mentioned in Chapters Four and Seven, the CIA has recently sanctioned one of its members for failing to conform to its standards. All of these developments will doubtless help to reduce the possible effects of the structural or systemic conflicts experienced by actuaries. On the other hand, none is as far-reaching as the requirement in the United Kingdom that the plan and the sponsor must each retain its own actuary unless otherwise agreed — a division of responsibilities similar to that already required in this province for accountants and auditors.

The inherently conflicted role of the actuary has given rise to another problem. If actuarial advice negligently or otherwise induces or permits sponsors to under-fund a plan, there is a risk that the plan, or its members, may sue for any loss suffered as a result. A successful lawsuit would likely involve the imposition of sizeable damages — a prospect that has made it difficult for actuarial firms to insure themselves against this possibility.

As a result, most actuaries assume that a valuation merely provides "information" to the sponsor, on the basis of which — along with other factors — the sponsor decides how much to contribute to the plan; inadequate contributions are therefore the sponsor's responsibility, not theirs. This description of the actuary's role is difficult to square with the fact that valuations are mandated by statute not just for the sponsor's consideration, but in order to alert the regulator to any potential problems, to protect the interests of active and retired plan members and, parenthetically, to safeguard the interests of the Pension Benefits Guarantee Fund (PBGF) — which may be called upon to make good the consequences of plan failure. I am, therefore, not persuaded by the argument that actuaries provide mere "information" or that they provide it only to the sponsor. If that "information" is not "fit for purpose," if it is based on a methodology that contravenes statutory or professional standards, or if it has been prepared negligently or improperly influenced by the primary client — the sponsor — to the prejudice of others whose interests are consequentially affected, the actuary should be made to answer for those consequences.

"Answering for the consequences" leads me to another concern. I was told that it is increasingly common for actuarial firms to require their clients to agree to indemnify them in the event they are sued by third parties, and to exculpate them from any claims by the client itself. I find this practice puzzling. If actuarial valuations are conducted with the explicit intent that they should be relied on by third parties — the regulator, active and retired plan members, and perhaps creditors or potential investors in the sponsoring corporation — insulating actuarial firms from the consequences of providing a valuation, which may have been compromised by conflicts of interest, creates a potential moral hazard.

Other professions whose members provide advice in comparable situations, and who enjoy comparable statutory monopolies over its provision, deal with the risk of third-party or client litigation in different ways: by self-insuring; by rigorous and proactive policing of their members; by providing them with education and guidance; and by establishing reasonable professional practice standards, compliance with which will shield members from inappropriate claims. (As noted in other chapters, the CIA already undertakes some of these measures.) All else failing, the legislature might be asked to define the types and limits of third-party liability to which actuaries should be exposed.

The root of all these problems, I reiterate, is not individual or collective wrongdoing by actuaries. Nor, by extension, is it illicit behaviour by other professionals, service providers or sponsors. It is that ambiguous structures and systems have been allowed to develop and to influence the way in which all these contributors to plan governance perform their respective roles. The way to put matters right is, therefore, not simply to prohibit, threaten or punish; it is to resolve the ambiguities by reforming those structures and systems.

As I noted in Chapter Four, to some extent this approach is being followed by the CIA on an ongoing basis as it seeks to reduce ambiguity in the valuation process by mandating greater transparency and consistency. Arguably, the introduction of "mark to market" accounting standards is another example of such an approach. In this chapter, however, my focus shifts to a possible complementary strategy — clearer delineation of the roles played by actuaries and other professionals in discharging their professional functions.

> **Recommendation 8-12** — The pension regulator and/or the proposed Pension Champion should initiate consultations with stakeholders and with representatives of the relevant professional governing bodies in order to ensure that their members provide services in the pension context in a manner consistent with the good governance and proper regulation of pension plans.
>
> These consultations should focus on rules governing the conduct of professionals in pension practice, and on the redesign of regulatory and governance structures and processes — in both cases, with a view to ensuring the honest and transparent administration of pension plans.

However, because of long-persisting ambiguities on the question, another essential component of reform must be the clear articulation of which professionals (including, but not limited to, actuaries) owe what fiduciary duties to whom.

> **Recommendation 8-13** — The pension regulator and/or the proposed Pension Champion should initiate consultations with stakeholders and with representatives of the relevant professional governing bodies in order to clarify:
>
> - which participants in the governance of pension plans are bound by fiduciary duties;
> - the scope of such duties;
> - whether such duties can be assigned to professional advisors and agents;
> - whether advisors and agents are themselves bound by the same duties; and
> - whether fiduciaries, their advisors and agents can enter into exculpatory contracts and indemnification agreements in order to limit their liability to the client or third persons.

> **Recommendation 8-14** — Following such consultations, the pension regulator should draw up codes of best practice for the guidance of all participants in the governance process. The regulator should urge the governing bodies of professions whose members are involved in the pension field to:

- adapt this code to the particular circumstances confronted by their members;
- implement the code, as adapted, through revision of their own professional standards, if required; and
- educate — and if necessary, discipline — their members in order to ensure compliance with the new standards.

> **Recommendation 8-15** — All persons responsible for providing valuations, reports or other documents that are filed with the regulator, or provided to active and retired plan members, should be required to certify that all such documents have been prepared in accordance with the law and with relevant professional standards.

The net result of these consultations and regulatory interventions should be that the governance process is improved to the point where it becomes largely self-correcting.

Knowledge

Those charged with governing a pension plan or administering its affairs are undertaking a task of considerable complexity. Even those with a professional background in a relevant discipline — law, accounting or actuarial science — may lack detailed knowledge of the pension field. And those without such backgrounds may have difficulty in learning what they should know.

Both lay and professional participants in the governance process ought to be knowledgeable. I use these terms — "professional" and "lay" — to distinguish between those who work extensively or exclusively on pension matters and those whose contact with pensions is more episodic. Obviously, the former should be expected to have a higher level of knowledge than the latter. However, both should be as knowledgeable as they can be and as they need to be to undertake their responsibilities. Moreover, some individuals will make the transition from lay to professional status. This is particularly true of people like union staff members and corporate executives who may begin by working on the pension file as part of a larger mandate but end up being acknowledged as experts in the field.

Some stakeholders took the position that what pension board members ought to know should be expressed in greater detail than the present statutory requirement of "all relevant knowledge." The U.K. *Pensions Act 2004*, for example, requires pension trustees to be conversant with all relevant plan documents, the law relating to pensions, and the principles relating to the funding and investment of pension funds. Indeed, the United Kingdom has adopted regulatory codes of practice setting out what is expected of both plans and of those who govern and administer them so as to ensure that sufficient knowledge and understanding are brought to bear on all aspects of the governance process. The United Kingdom's effort to ensure that governing board members and other actors are provided with low cost, standardized and quality-assured training programs ought to be replicated in Ontario. Such training and quality assurance programs ought to be made especially attractive and accessible to trade unions that are going to have to expand their cadre of trained pension personnel if they are to take up the governance opportunities and responsibilities proposed for them in this report.

Fortunately, education for governing board members in Ontario is already available through programs established by educational institutions, commercial providers and unions. However, by no means do all board members participate in these programs; nor has a minimum standard of knowledge or level of training for board members been established either by the regulator or — with some exceptions — by individual plans; nor has the success of existing programs in equipping board members for their important roles in the pension system been systematically evaluated. Indeed, a number of stakeholders expressed concern that lay board members are likely to lack the capacity to participate effectively in the variety of governance roles that I recommend for them in this chapter and elsewhere in this report.

> **Recommendation 8-16** — An early task for the proposed Pension Champion should be to consult with pension stakeholders, relevant professional bodies, educational institutions and the pension regulator with a view to determining what lay and professional participants in plan governance ought to know about pension plans and the pension system, how they might best acquire such knowledge, and to what extent its acquisition should be a necessary qualification for service as a trustee or administrator of, or advisor or service provider to, a pension plan.

> **Recommendation 8-17** — Following the consultations outlined in Recommendation 8-16, the Pension Champion ought to develop standards for educational programs for all participants in pension governance. The Pension Champion ought also to determine how educational programs should be provided and at whose expense, and whether acquisition of appropriate educational qualifications should be mandatory and, if so, for the performance of what functions.

I note that considerable progress has been made in recent years in providing education and training for corporate directors. While to the best of my knowledge no study has yet demonstrated a commensurate improvement in the quality of corporate governance, it is difficult to see that the outcome could be otherwise. This example should be persuasive for the pension community.

Efficiency

In Chapter Nine I briefly review evidence that suggests that significant economies of scale, as well as other advantages, accrue to large pension plans. I also suggest how small- and medium-sized plans can secure some, if not all, of these economies and advantages by entering into different forms of association with each other, with large plans or with service providers. In the present context, however, I want to reiterate a point I made earlier. It is difficult for any pension administrator, or any pension governance body, to know whether a plan is efficient if it does not have benchmarks against which to measure itself. In Recommendation 8-1, I propose the means by which such benchmarks might be initiated and applied.

Success

There are no infallible strategies that will guarantee the success of pension plans, nor indeed any "objective" ways of measuring success that can fully account for the unique and often uncontrollable circumstances within which each plan operates. However, it is essential that plans be success-oriented. This requires that governance bodies analyse the challenges they confront, develop realistic strategies to deal with them, and subject themselves to accountability mechanisms to ensure that those strategies are producing the required outcomes.

Moreover, the success of individual plans has somehow to be generalized across the system. I visualize a virtuous circle whereby plans learn how to succeed, then share what they learn with others with a view to identifying and encouraging best practice for pension plans — and finally, after a period of further experimentation and learning, best practice is consolidated, codified and promulgated as a code of best practice. The code may not have legal effect in itself, and often should not, because one would not wish to foreclose further experimentation that could lead to even better ways to do things. Nonetheless, a code of best practice would serve as *prima facie* evidence that plan governors, administrators and service providers had met the minimum standard laid down in the PBA: that they had used the "skill and knowledge that [they]… ought to possess by reason of their profession, business or calling."

> **Recommendation 8-18** — The regulator should develop codes of best practice to guide plan governors, administrators and their agents. These codes of best practice should be based on the experience of successful plans, disseminated across the pension system and used to give meaning to the general statutory requirements for "prudence," "care," "diligence" and "skill."

8.3.3 Information for plan members and their representatives

The PBA requires that plan members receive annual statements containing a great deal of plan information, though oddly, not information on the effect of the plan's funded status on their personal pension entitlement — arguably what they most want to know. The PBA also requires that new members be given an explanation of the provisions of the plan that apply to them. Nonetheless, stakeholder groups representing plan members and retirees complained frequently about the absence, inaccessibility or incomprehensibility of information about their plan and their pension. At one level, this problem is almost unavoidable. Most pension plans — the texts that initiate them, the legal rules that regulate them — are complex, arcane and fully intelligible only to experts and professionals. It is therefore difficult even for people who are given "the facts" — triennial valuations, annual statements and the like — to know what to make of them. Consequently, many plan members and retirees simply do not read what they are given.

(A digression: The *Labour Relations Act* requires that the administrator of any pension plan whose members are represented by a trade union must file with the Ministry of Labour detailed audited annual statements that include a description of plan coverage; contributions made by the sponsor and members; a statement of assets and liabilities; and a record of salaries, fees and expenses charged to the plan. The administrator must make a copy of this statement available to plan members on request and without charge. My sense is that few pension experts — let alone ordinary plan members — are aware of this legislation, and that it is seldom invoked. Persons in search of information about a pension plan are more likely to ask the pension regulator to provide it, even though the present arrangements for access to such information are not user-friendly. My conviction is that all plan members, not just those who belong to unions, should have access without charge to similar information presented in a similarly convenient form. And my suggestion is that in the interests of consolidating administrative responsibility for pensions, the PBA should be amended to ensure that sponsors make available any information mentioned in the *Labour Relations Act* that is not already required under the PBA, and that the pension information provisions of the *Labour Relations Act* should then be repealed.)

Now the difficult question: If plan members and retirees often cannot understand and/or do not read the information that they are required by law to receive, why should the law continue to insist that such information be provided to them?

There are several answers to this question. The first is that more members might read and understand the information if it were provided in a more user-friendly form — in plain English and/or the dominant language of the workplace — and if it were more carefully designed to answer the questions most pertinent to them. The second is that in the event a problem arises, whatever information is provided to members may be used by the regulator, a union official or a lawyer to resolve their problems, or at least to provide a basis for further inquiries. The third is that transparency is a good in itself — a principle enshrined in consumer and shareholders' rights, statutes and in access to information legislation.

At the very least, information required to be disclosed to the regulator should continue to be available as well to active and retired plan members, their unions or other representative organizations and their professional advisors. And the means of making information available should be improved — in particular, by providing some form of secure on-line access for those who are unable to visit the regulator's offices in person.

> **Recommendation 8-19** — The regulator should make available on-line to active and retired plan members and their authorized representatives — without charge but subject to security arrangements — all plan documents as well as triennial, annual or other valuations and reports required to be filed with the regulator.

In fact, many major Ontario plans have adopted ambitious information programs. Many of the largest and newest of these plans — especially JSPPs — have websites that provide annual reports and governance statements; information on board members; statements of investment policy; proxy voting guidelines; explanations of new investment strategies; and a variety of news bulletins, fact sheets and e-magazines. Some plans carry out surveys of plan members on proposed new benefits, surplus use and other developments. While some plans restrict website access to active and retired members, others have open websites. Many also facilitate two-way on-line contact between the plan administrator and members.

On the other hand, traditional forms of communication still work well for some plans and plan beneficiaries. These include the conspicuous posting of information in the workplace, mailings, information pamphlets and annual membership meetings. The point is that every plan should have an information policy and should adhere to that policy so that active and retired members have the information they need and are entitled to.

Recommendation 8-20 — The regulator should develop guidelines and codes of best practice with regard to the provision of plan information to active and retired members in accessible form.

Even more important to members than general information concerning the plan is information pertaining directly to their own situation.

Recommendation 8-21 — Plan administrators should provide an annual information statement to active and retired plan members in easily understood language or languages. The statement should include:

- a simple description of how pensions are funded and benefits are calculated under the plan;
- information on the plan's funded status (including whether it is in surplus or deficit and whether a contribution holiday is in progress or contemplated);
- the potential impact of its funded status on active and retired members' pensions; and
- a telephone number and/or website address where further information can be obtained from the administrator or the sponsor, and similar coordinates for the pension regulator.

8.3.4 Governance, funding and investment policies

The development and publication of operating policies, which outline organizational decision-making practices, is as desirable for pension administration as it is for corporate and public governance. Disclosure of this information achieves several goals: it ensures that senior pension staff and trustees will discuss how decisions are presently made in the pension fund; it requires regular review and evaluation of decision-making processes; it establishes the occasion for discussion of any necessary changes; and it promotes transparency in all aspects of pension plan administration. This last feature is particularly important because it demystifies the plan, reassures plan beneficiaries that its administration is open to new ideas and committed to improving performance, and reduces the likelihood that ill-informed rumour-based campaigns will destabilize the governance process.

In general, governance policies should reveal how board members, the administrator, senior staff, professional advisors and service providers are selected; the nature of their responsibilities; their access to ongoing training; any remuneration or perquisites provided to them; and the constraints to which they are subject, such as conflict of interest rules. Funding policies should reveal how the plan intends to make the pension promise secure, the assumptions underlying anticipated long-term approaches, and strategies for dealing with different funding scenarios. And investment policies should identify the strategy adopted by the plan to optimize the returns on its investments, steps taken to guard the plan against unacceptable levels of risk, and approaches by the plan to the selection and oversight of its investment advisors.

Under federal rules, administrators must adopt (but need not file) Statements of Investment Policy and Procedures (SIP&P) that set out in general terms the plan's objectives in making investments. In my view, such statements should be adopted not only to facilitate investment planning, but to enable plan members to evaluate the quality of plan administration, and to enable the regulator to develop a compendium of best investment practices, which it can then use for benchmarking purposes.

> **Recommendation 8-22** — Plan board members, governors or trustees should prepare, file with the regulator and make available to active and retired members at three-year intervals (or more often, if material changes have occurred) the plan's detailed governance, funding and investment policies. Particulars of the matters to be addressed by these policies should be developed by the pension regulator in consultation with the stakeholders. Template policy statements should be developed for the assistance of smaller plans.

One aspect of investment policy deserves special mention. In recent years, plan beneficiaries and trustees increasingly want to know not only that pension funds are profitably and safely invested, but also that they are invested in companies that behave as good corporate citizens should. In particular, they are sometimes keen to ensure that the leverage exercised by their plan as a significant shareholder is being deployed in support of decent social and environmental policies when these concerns are raised at annual shareholder meetings or in other forums.

It remains somewhat uncertain precisely how, in practical and legal terms, the decisions of trustees and administrators to pursue socially responsible investment (SRI) can be reconciled with their duty to maximize the plan's investment returns for the benefit of its active and retired members. However, there is a growing global consensus that trustees must at least have a considered and informed discussion on the issue. The U.K. *Pensions Act 2004* requires trustees of occupational pension plans to disclose in their Statement of Investment Principles whether they adhere to an SRI approach to investment; likewise in France, Germany, Belgium and Sweden. Canada's federal pension regulator, the Office of the Superintendent of Financial Institutions (OSFI), now requires plans to disclose how they vote their proxies at shareholders' meetings on SRI issues, which, in turn, requires them to reveal whether the plan itself has an SRI policy.

> **Recommendation 8-23** — Plan statements of investment policy should reveal whether, and if so, how, socially responsible investment practices are reflected in the plan's approach to investment decisions.

8.4 Participation in Governance by Active and Retired Plan Members

8.4.1 Introduction

In several sections of this chapter I have suggested why participation in plan governance by all classes of plan members is important in itself and how it may affect the intensity of regulatory oversight to which plans are subject. In this section, my focus is on the ways in which participation can be encouraged, and the forms that it might take.

8.4.2 Mandatory advisory committees

The PBA already contemplates that "members and former members" of a pension plan may establish an advisory committee by the simple expedient of holding a vote and securing a majority of those voting. These committees must provide for representation of each class of plan members — active, retired and, presumably, deferred. However, their functions are somewhat vaguely defined — to "monitor" the plan, to "make recommendations to the administrator" and to "promote awareness and understanding" of the plan. Moreover, some sponsors are reluctant to assist advisory committees in contacting members and retirees due to concerns about legal privacy restrictions; requests for detailed — even basic — information about plans sometimes do not elicit an adequate response; and, as a result, it seems, advisory committees are neither effective nor numerous.

For reasons already discussed, I believe that substantive gains would accrue to the system and to individual plans from greater member participation. This proposition is already being tested, with generally favourable outcomes, in JSPPs and, perhaps to a somewhat lesser extent, in MEPPs. However, in most SEPPs, it is not. I am therefore confronted with the familiar (and fair) question: "if we build it, will they come?" If SEPP advisory committees are equipped with appropriate mandates and powers, will members and retirees want to participate? Will they find ways to use such committees constructively to improve plan administration, while respecting that formal decision-making authority continues to reside with the sponsor (subject, in some cases, to constraints imposed through collective bargaining)? Or will members decline to participate and leave the advisory committee a hollow shell, a reminder of my misplaced confidence in the desire and capacity of workers to participate in the governance of their own affairs?

The only way to answer this question is to experiment with the form and function of advisory committees. In large, diffuse enterprises, for example, they may be viable only in virtual form — as electronic networks that hold "town hall meetings" on-line. In small workplaces, they may find a home under the union's organizational umbrella. In declining one-industry communities, they may become very active by drawing on the daily personal contacts of plan members and their shared concerns about the future. I am not troubled by the fact that these committees may look very different from each other, at least initially.

However, they will all have certain tasks in common: securing and analysing information concerning the plan, and distributing the results to the active and retired members; and conveying the views of members to the sponsor or administrator. Advisory committees might also assist when (if my recommendations are followed) member votes are held on proposals such as the resetting of plan obligations on insolvency. However, since their functions are purely advisory and have no legal effect, members of advisory committees should not be held to the same legal standards as members of the formal institutions of plan governance; nor should the functions of these committees be specified in great detail by legislation.

Nonetheless, however structured, advisory committees should be properly equipped to do their work.

> **Recommendation 8-24** — Except as provided in Recommendation 8-26, every pension plan should be required to establish a pension advisory committee (PAC). A PAC should comprise at least five members, including one representative selected by retired members and one by each class or group of active members.

When plan members are represented by one or more trade unions or equivalent organizations, such unions or organizations should nominate their PAC representatives.

Recommendation 8-25 — The PAC should:

- be provided with effective means of communicating with all plan members, including retired members;
- have access to all information distributed to plan members or filed with the regulator;
- receive notice of all amendments, applications, proceedings or transactions involving the plan; and
- be informed of all votes or consultations designed to solicit the views of plan members.

The PAC should present annually to plan members a report on the state of the plan and an account of its own activities during the year. This report should be distributed with other information that the administrator is required to provide to plan members.

Recommendation 8-26 — No PAC need be formed when (a) a plan provides for the participation of active and retired member representatives on its governing body, (b) a collective agreement provides for a joint sponsor–member–retiree advisory committee, or (c) a majority of active and retired members vote in a secret ballot not to establish a PAC.

I hope that positive experience with PACs will encourage employers, workers, sponsors and members to start down the road to a more fully realized model of joint governance. That is the subject of the next set of recommendations.

8.4.3 Shared governance

A majority of plan members are already enrolled in MEPPs and JSPPs, both of which provide for member participation in plan governance. (Retirees from these plans will gain comparable rights of participation if the recommendations below are accepted.) However, the sizeable minority of plan members enrolled in SEPPs seldom, if ever, have access to such participation. I believe they should, and that participation may be in the sponsor's interest as well as their own.

In one sense, of course, that possibility is readily available: SEPPs can convert themselves into JSPPs if workers and/or their union agree to contribute to their pension plan along with the employer, and if sponsors agree to give up unilateral control of the plan in favour of a shared governance model. However, this approach has not found favour outside the public sector — the only sector where JSPPs have so far taken root. I therefore make my next recommendation in the hope that it will persuade some SEPP sponsors and members to consider the attractions of joint governance more carefully.

> **Recommendation 8-27** — The sponsor of a single-employer pension plan may enter into an agreement with a trade union, or other union-like organization that represents plan members, to establish a jointly governed target benefit pension plan. Such plans should (a) be governed by a board of trustees or comparable body on which representatives of plan members and retirees should comprise not less than one-half of its members, (b) offer target benefits, and (c) be funded on the same going concern basis as multi-employer and jointly sponsored plans.

The jointly governed target benefit pension plan (JGTBPP) offers members and retirees a voice in plan governance — a voice that becomes more audible because it will also be heard in negotiations over wages and working conditions. And it offers sponsors a way of retaining the labour market benefits associated with single-employer plans but at the same time relief from solvency funding, and a technique — target benefits — for ensuring that plan liabilities will not in the end outstrip plan assets.

The JGTBPP is not a perfect solution to the problem of dwindling SEPP membership. It can be seen by sponsors as a derogation from unilateral control, and by unions and their members as a retreat from conventional DB benefits. However, in a context where single-employer plans are becoming increasingly rare, the JGTBPP is, quite frankly, a strategy designed to tempt employers back into offering pensions and to ensure that plan members and retirees are not left with high aspirations but no pension coverage.

My belief that good governance has the potential to resolve pension issues lies at the heart of my proposal to establish JGTBPPs. I therefore deem it essential that governance of these plans be conducted in an exemplary fashion, in accordance with the high governance standards I discuss earlier in this chapter. Indeed, the JGTBPP can serve as the proving ground for many of those standards.

8.4.4 Retired member participation in plan governance

Seniors and retirees made clear at the Commission's hearings that they resented being described in the PBA and in plan documents as "former members;" that they were sometimes refused effective access to plan information by sponsors, the regulator and even in some cases by their own union; and that they were usually denied the right to participate in governance decisions, including those that might adversely affect their pensions. An example of the latter situation, discussed above, would be the decision of an under-funded union-administered MEPP to reduce pensions already in pay. Finally, those who were formerly union members suffer double disfranchisement, since retirement deprives them not only of a voice in the affairs of the pension plan, but also — in most unions — of a role in union decision-making.

It is inappropriate, I feel, that retirees should be denied a voice in decisions that crucially affect their interests. It is counterproductive to deprive plans of the benefit of their knowledge and experience. And it is unnecessary, because procedures can be devised to accommodate their interests and give them a place in plan governance, at least where active plan members enjoy the right to participate. Given that they may need the same technical advice and backup support that unions usually provide to active members serving on governing boards, retired members should be able to seek assistance from, and nominate as their representatives on any governance body, officials of organizations of retired persons, professional advisors or other persons of their choosing.

Recommendation 8-28 — The *Pension Benefits Act* should be amended to describe pensioners as "retired" rather than "former" plan members.

Recommendation 8-29 — Retired and deferred plan members should be assured effective access to all plan information available to active plan members.

Recommendation 8-30 — Retired plan members should be eligible to participate in any plan governance process in which active plan members are eligible to participate. The extent of their representation and participation in governance should be determined by the governing body of each plan, but must be sufficient to ensure that their voice is heard and their interests protected.

CHAPTER NINE – INNOVATION IN PLAN DESIGN

9.1 Introduction

9.1.1 Why innovation is important and so difficult

How can our system of voluntary pension plans be sustained and enlarged while protecting the security of members' entitlements and affordability for sponsors? In this chapter I argue that the achievement of these seemingly contradictory objectives is indeed possible — but only if we can move beyond conventional understanding of defined benefit (DB) and defined contribution (DC) plans, and of why they are able to provide the attractive outcomes for which they are rightly prized. Doing so will enable us to think about innovative pension designs, which constitute a blend of DC and DB models, refinements or adaptations of the DB model, or the introduction of new types of plans that are its functional equivalent. In my view, the introduction of innovative plan designs based on new ways of thinking represents the best hope for reinvigorating our DB system.

If innovation is so critical, why is it so difficult to achieve? Broadly speaking:

- When the pension system is working well, no one sees the need for innovation; and when it is not, people are too pessimistic to take chances.
- In a complex, highly regulated field such as pensions, where arrangements involve the fortunes and lives of many people over many decades, a burden of persuasion rightly rests on proponents of change to demonstrate that the "new" will constitute an improvement over the "old."
- The *Pension Benefits Act* (PBA) and the *Income Tax Act* (ITA) lack specific mechanisms to facilitate the introduction of new pension designs; moreover, changing either statute requires political will and a priority position on the legislative agenda, both of which are hard to come by — particularly at the same time.
- Technical concepts — such as "defined benefit" or "defined contribution" — have a powerful hold on pension professionals and policy makers. To describe or discuss innovative plan designs, it is necessary either to re-define these concepts or invent a new (and perhaps clumsy) conceptual vocabulary.
- The intellectual investment of regulators, sponsors, unions, pension professionals and service providers in the status quo sometimes causes them to over-value existing arrangements and to mistrust innovation.

These last two barriers to innovation warrant special attention.

9.1.2 Re-examining the defined benefit/defined contribution distinction

Debates on pension issues often juxtapose "classical" or "pure" DC plan designs with "classical" or "pure" DB designs. Differences between the two are canvassed extensively in Chapters One and Two, and can be briefly summarized as follows:

- In DC plans, the investment risk is borne by individual plan members; in DB plans, it is borne by the employer and/or spread across the plan membership (the point is hotly debated in the context of surplus ownership and elsewhere) — and, it varies as among single-employer pension plans (SEPPs), multi-employer pension plans (MEPPs) and jointly sponsored pension plans (JSPPs).
- In DC plans, the longevity risk is generally borne by individual plan members (although in principle, individual members might purchase a life annuity upon retirement); in DB plans, it is spread across the entire present and future membership of the plan.
- In DC plans, where contributions are made according to a set formula, regulatory oversight is reasonably light; in DB plans, where funding is on the basis of complex valuations based on multiple, volatile factors, oversight is intense and ongoing.
- In DC plans, the clear, segregated individual account format leaves little room for insolvency risk; in DB plans, members — particularly of SEPPs — do bear the risk that a sponsor may fail with an under-funded plan.
- In DC plans, if members leave, their entitlements can be easily ascertained, monetized and transferred to another plan or a locked-in account; in DB plans, individual entitlements are difficult to disentangle and not easily transferable.
- In DC plans, contribution formulae may be adjusted from time to time, or contributions may be increased automatically as wages rise, but the member's entitlement is the fixed capital accumulation on retirement; in DB plans, pensions adjust automatically prior to retirement as salaries and length of service increase and are sometimes inflation-adjusted after retirement as well and supplemented by ancillary benefits.
- In DC plans, members end up with a range of options around investment decisions, including making their own; in DB plans these are made by professional advisors. (This point is not trivial. A recent U.S. study showed that from 1995 to 2006, the investment performance of DB plans, on average, exceeded that of DC plans by 1% a year; over the 11 years under study, the cumulative effect was a 14% advantage in favour of DB plans. Further investment advantages in favour of DB plans are described below.)

When their characteristics are starkly contrasted in this fashion, DC and DB plans appear to be so different from each other that a binary distinction between them is inevitable: a plan is either DC or DB, but it cannot be both. However, this is patently not the case. Many plan designs have emerged that are, strictly speaking, neither "pure" DC nor "pure" DB. They may be hybrids containing layered elements of both DC and DB plans, or sufficiently distinct that they might be considered a species in themselves.

In my view, setting aside the notion of “pure” or “classic” DC and DB plans is the first step toward re-imagining the pension system as one that includes a wide range of innovative designs with characteristics of both or neither. The second step is to revisit DB plans to see what makes them so attractive.

The key advantage of DB over DC plans is the greater capacity of the former to insulate individual workers from risk. In DB plans, as noted, the investment risk is, to some extent, transferred from the members to the sponsor, while the longevity risk is spread across the entire present and future membership of the plan — the larger the membership, the more efficiently managed the risk. However, DC plans do not offer the opportunity for either form of risk management. Individual members manage their own accounts on retirement. If they manage badly, encounter adverse market conditions or live longer than they anticipate, they will find themselves without sufficient pension income and will have to depend on their Canada/Quebec Pension Plan (C/QPP) and Old Age Security (OAS) public pensions. The result will likely be a reduction in their standard of living. DB plan members do not have to deal with these contingencies on their own. Barring the catastrophic failure of their pension plan — a relatively rare event against which they may be partly buffered by the Pension Benefits Guarantee Fund (PBGF) — they will receive the pension they expect, and it will last them as long as they live. Risk-spreading makes the difference, and size allows risk-spreading and other efficiencies to work better.

This analysis seems to lead to the following conclusion: the way ahead for occupational pensions in Ontario lies with large innovative plans rather than with relatively small, conventionally structured DB and DC plans. However, this is not to say that large innovative plans represent a universal “cure” for the DB system:

- Although innovative plans will approximate DB plans in some important respects, they will not replicate them in every particular.
- Innovative plans will therefore not forcibly displace “classic” DB plans; a shift from the latter to the former will occur only if sponsors and the unions with which they negotiate their pension plans are persuaded that an innovative alternative provides them with similar or superior outcomes at lower cost.
- Innovative plans are not inevitably large plans; some small- and medium-sized sponsors will wish to operate their own plans rather than merging them with a larger plan because they believe that doing so will better enable them to use pensions as a tool to recruit and retain key workers.
- Innovative plans should not be entitled to favourable regulatory treatment just because they are innovative; they must be shown to manage risks in an acceptable way.
- Innovative plans will not appeal to employers who have no interest in providing pension coverage for their workers; however, they should appeal to employers who are considering or are being pressed to initiate a pension plan but are hesitating because of the well-known criticisms of DB plans.

Nonetheless, if innovative designs can arrest the decline in pension coverage — as I think they may — they will make a significant contribution to Ontario’s social and economic policy. And if they can actually reverse the decline so that a higher proportion of workers gains access to pensions over the next 10 or 20 years, that contribution will be ranked as very valuable indeed.

9.2 Promoting Innovative Plan Design

Many innovative models already exist in Ontario and in other jurisdictions that either combine elements of DC and DB designs, or constitute a significant departure from them. A few examples make the point.

Hybrid plans

One hybrid plan model (popular, for example, among universities) combines DB and DC models by offering a DC pension, but with a minimum DB floor of protection. Thus, the advantages of both designs may be achieved to some extent. Other combinations are possible, subject always to existing legislative constraints.

Cash balance plans

Cash balance plans are, in essence, DC plans. However, the plan sponsor guarantees a defined rate of investment return on members' accounts, often fixed by reference to an outside index (AAA Corporate Bond rates, for example) and in excess of what members could expect to receive by themselves investing in a conservative portfolio. The effect of this guarantee is to relieve individual members of the expense of professional investment management and to shift part of the investment risk to the plan sponsor. To this extent, cash balance plans become the functional equivalent of DB plans.

However, these plans do not qualify for registration under Canada's tax laws, effectively preventing their operation in Ontario. Moreover, though common in the United States, cash balance plans have been controversial because the sponsor retains all investment gains in excess of the promised minimum. For present purposes, I merely cite them — without endorsing them — as another example of innovation that is perhaps worth investigating.

Contingent benefit plans

Contingent benefit plans — in contrast to cash balance plans — are structured to return investment gains, if there are any, to the beneficiaries. They are, in effect, DB plans that specify that certain benefits will be paid only if the plan funding is healthy.

For example, several Ontario pension plans now pay full indexation of retirement benefits only if the plan can afford these payment increases; otherwise — pending replenishment of the fund — partial or no indexation is provided. Or to take another example, pension plans in the Netherlands are career average plans in which the wage base is adjusted upward if the plan funding is adequate. The effect is that over time, and so long as funding will support this gradual shift, they may come to resemble final average plans. These examples suggest other possible experiments with the contingent benefit formula. For example, one might design a pension plan under which 90% of the promised benefits are absolutely guaranteed, but the other 10% are paid only if the plan is healthy.

Target benefit plans

In a target benefit plan, contributions are fixed, and on the basis of a best estimate of what the funding will provide, benefits are promised. However, if it is later determined that the "target" benefit cannot be achieved with the available resources — contributions and the return on investment — both accrued and future benefits can be adjusted downward and, for that matter, upward, if and when the plan's fortunes recover. Thus, from the viewpoint of the member, the plan may be perceived as a DB plan. Indeed, the benefit is defined and has all the characteristics of a DB plan except one: it is contingent on the plan's success. However, from the viewpoint of the plan sponsor or sponsors, the plan functions like a DC plan. Contributions are fixed or defined: once those contributions have been made, the sponsor has no obligation to make good any notional deficiency, because the benefits will be adjusted rather than paid in full.

Target benefits may presently be provided only by multi-employer plans, subject to two limited exceptions. First, DB single-employer JSPPs are precluded under existing legislation from offering target or variable benefits while ongoing, but may reduce benefits on wind-up if the plan is under-funded. Second, collectively bargained DB SEPPs, while still ongoing, may provide for fixed or defined contributions and for the reduction of benefits in the event that a funding deficiency results. However, unlike JSPPs, this particular DB model does not provide for unions to participate in plan governance, is therefore apparently unattractive to them, and is in fact rarely used.

In my view, it ought to be possible to offer target benefits in a single employer plan under certain circumstances. The jointly governed target benefit pension plan (JGTBPP), proposed in Chapter Eight, may well appeal to some prospective sponsors, unions and workers — especially when the alternative is no pension coverage at all.

Given the risks associated with self-administered SEPPs (discussed in Chapters Four and Eight), and the limited appeal of the present provisions for reducing benefits in collectively bargained plans (discussed above), I have proposed that the new JGTBPP should be available where workers both belong to a trade union or equivalent organization, and are represented on the plan's governing body. These interlocking requirements should ensure that beneficiary interests will be considered in fixing the levels of employer contributions and target benefits, lend economic force to workers' demands that the sponsor/employer fund the plan at the proper level, and ensure that member representatives will have an effective voice in the plan's governance process.

Member-funded pension plans

Member-funded pension plans (MFPPs) — a new DB plan design developed in Quebec — contemplates that, as in a DC plan or an Ontario-style MEPP, the sponsor's obligation will be limited to the contribution of a fixed amount. Whatever additional funds are required to pay the promised benefits will be contributed by the members who thus collectively assume the financial risk. Given the limited capacity of workers to do so, however, these plans are to be subject to very strict funding rules that effectively require them to be fully funded at all times. MFPP governance structures are carefully prescribed and they must be embedded in a collective bargaining relationship.

Promoting innovation

There are significant differences in detail and degree among these existing and proposed innovative, union-negotiated, member-governed target benefit and/or multi-employer plans, and within each plan type. However, they share certain common characteristics: they depart in some significant way from the model of "pure" DB plans; they deliver somewhat similar but not identical benefits; and they are generally big enough to spread risks widely, achieve efficiencies of scale and to exercise leverage in investment markets. Although each may have some shortcomings, such plans appear collectively to represent some part of the future of the Ontario pension system: they already account for 60% of all plan members and 70% of all DB plan members — percentages that should grow if my recommendation to initiate JGTBPPs is accepted.

> **Recommendation 9-1** — Innovation in plan designs should be promoted and facilitated by the proposed Pension Champion (see Recommendation 10-5).

Legislation and regulations that inhibit innovation should be reviewed and revised with a view to enabling the introduction of plan designs not now permitted, if such designs meet criteria to be set out in the statute. If the federal *Income Tax Act* represents an obstacle to otherwise desirable innovation, the Ontario government should approach the federal Minister of Finance with a view to removing such obstacles.

9.3 Promoting Larger Plans

As noted above, spreading certain risks across large populations results in more predictable outcomes and less volatility. Examples of these variables include life expectancy and age at retirement. This size advantage is compounded along almost every vector of plan success. For example, large plans pay far lower fees on their investments than small ones, as Table 1 illustrates.

TABLE 1: INVESTMENT FEES BY SIZE OF PENSION FUND

SIZE OF PENSION FUND	INVESTMENT FEES FOR LARGE-CAP EQUITIES
Individual account	250–300 basis points
$10 million	60 basis points
$1 billion	42 basis points
$10 billion	28–35 basis points

Table 2 tracks the impact of investment expense ratios and shows how profoundly they can affect the aggregate pension benefits and working income replacement rates of retired plan members. The example used assumes an annual contribution to a plan of $10,000 over 40 years by or on behalf of a worker making $50,000 per year.

TABLE 2: IMPACT OF INVESTMENT EXPENSE RATIOS ON PENSION ADEQUACY

EFFECTIVE EXPENSE RATIO	0%	0.4%	1.5%	3%	5%
Annual contributions (over 40 years)	$10,000	$10,000	$10,000	$10,000	$10,000
Accumulated value (after 40 years)	$777,000	$707,000	$551,000	$400,000	$272,000
Annual pension payment	$45,000	$41,000	$32,000	$23,000	$16,000
Working income replacement rate	90%	82%	64%	46%	32%

However, lower investment fees are but one of the many advantages enjoyed by large plans over smaller ones and over individual savers. In terms of income generation, large plans are in a position to hire expert staff to initiate and execute their investment strategies, to make attractive private placements of their investment funds, and to spread the investment risk by acquiring a wider range of investment vehicles. In terms of administrative expense, large plans are able to reduce their unit costs of administration by spreading them across a large plan membership, and they are typically able to offer members enhanced levels of information, education and service. Finally, large plans are more likely to survive than smaller ones, if only because the enterprises (or groups of enterprises) that sponsor them are likely to be more stable or resilient than those that sponsor small plans.

The cumulative effect of all of these advantages is extremely significant. It is so significant, in fact, that plan size may be a greater determinant of a member's pension than plan design. Or, to make a more modest claim — holding plan design constant — large plans will generally perform better than small ones.

Keith Ambachtsheer, in his recent C. D. Howe paper, suggests that assets of $10 billion are necessary to claim the economies of scale and leverage in financial markets. In fact, most JSPPs and some very large DB SEPPs have already achieved that critical size, and a number of MEPPs have come close. On the other hand, most DC plans and smaller SEPPs (especially non-union SEPPs, which account for about 17% of all plan enrolments) have not. Any strategy for preserving and enhancing our pension system ought therefore to place special emphasis on assisting small- and medium-sized plans to either become large, or to combine forces with other small- and medium-sized plans in order to claim the advantages available to large plans. It must also ensure that the very favourable investment expense ratios thus achieved are passed on to plan members.

> **Recommendation 9-2** — Pension policy and legislation ought to facilitate the growth and operation of large-scale pension plans or to enable and encourage cooperation among small- and medium-sized plans.

The logic of this position leads me to explore the very largest plan of all in Canadian terms — the Canada Pension Plan (CPP) — to see whether it exhibits design features that could be transferred to private or public sector occupational pension plans.

The CPP is huge. In 2006, 12.1 million Canadian workers made contributions to the CPP, while 3.4 million Canadians received benefits as retired workers, and another 1.1 million received retirement benefits as survivors of deceased retired workers. Because of amendments in 1996, the CPP is now partially funded and the Canada Pension Plan Investment Board now has $120 billion of investable funds managed by a professional staff of 400 analysts.

Most Canadians understand the CPP to be a DB plan since its funding is driven by a triennial actuarial report and its benefits are clearly defined by legislation. However, if one looks more closely, the CPP bears much more resemblance to a MEPP target benefit plan. Thus, the benefit structure of the CPP has changed many times since its inception in 1966, and in response to financial difficulties, at one point it decreased benefits for future retirees by close to 10%. If current contribution rates cannot sustain promised benefits, and no alternative is agreed to, benefits will automatically be reduced again. In this respect as well, the CPP more resembles a "target benefit" MEPP than it does a "pure" SEPP DB plan.

Thus, the example of the CPP reinforces my belief not only that size matters to the success of a plan, but also that the "target benefit" strategy is worth emulating.

9.4 A New Strategy for Ontario's Occupational Pensions System

The two themes of this chapter — the need to complement "pure" DB or DC pension designs with innovative alternatives, and the need to provide all pension plans with the advantages of scale now enjoyed by a few — lead me to propose a new overall strategy for Ontario's pension system.

Under this strategy, small DB plans, DC plans and individual savers with no access to occupational plans would be permitted and encouraged — but not required — to associate themselves with super-plans (those with assets in the range of $10 billion). These super-plans might operate in several ways. They might:

- extend full membership to workers previously enrolled in small plans and provide them with DB coverage;
- provide the nucleus around which new MEPPs might be formed by enlisting numbers of small SEPPs;
- offer standard MEPP-like target benefits to members of associated plans while requiring sponsors to make only fixed contributions; or
- provide investment or administrative services to associated plans, which would otherwise continue to operate on their original terms.

In order for any of these things to happen, however, a new approach to pension regulation would have to be adopted.

First, the government would have to allow Ontario's existing large plans to amend their membership criteria and mandates. Some of those plans are created by trust documents or other private instruments; some are the product of special statutes. In either case, a fairly simple procedure should be established to make it possible for them to broaden the scope of their activities and the qualifications for plan membership, if they wish to do so. For example, large plans should be allowed to offer investment services to smaller plans and sell investment vehicles to individuals. Many of these plans, I believe, would welcome such an opportunity, as they are reaching a point of maturity past which their future net cash flows will shrink, and their ability to undertake new investments will be severely reduced. Without new members and new cash flow, their existing investment expertise will be under-utilized and, ultimately, difficult to sustain.

Second, the government or the proposed Pension Champion should encourage existing MEPPs to extend their mandates — again, by fairly simple means such as a resolution of the trustees or a referendum of the members. For example, construction MEPPs might be willing to combine with each other and to include workers in adjacent industries such as trucking or building products. This would obviously require inter-union cooperation, in which regard the present Ontario Municipal Employees Retirement System (OMERS) plan may represent a useful precedent.

Third, both SEPPs and MEPPs should be allowed to commingle their investments, as public sector unions have done in British Columbia under the British Columbia Investment Management Corporation (BCIMC), and federally under the Public Service Pension Investment Board. This might best be accomplished on a sectoral basis using TIAA-CREF in the United States as a model. TIAA-CREF manages the retirement plans of 3.4 million individuals from 15,000 institutions (mainly academic) and has $420 billion of assets under management. Obviously, the government would have to enact enabling legislation to permit commingling.

Fourth, it may be possible to encourage the emergence within the financial services industry of a large-scale, low-cost private agency to provide pensions to individual workers and members of small plans who must now buy pension coverage at very high cost or not at all. Aggregating their pensions in a commingled fund would enable them to secure retirement income on more reasonable terms than are presently available. One way to accomplish this might be for the government to call for proposals to establish such an agency and to run it for a fixed term — say 10 or 15 years — subject to renewal if the winner's performance has been satisfactory or after new bids are sought.

Finally, the voluntary pension sector could be expanded beyond the employment relationship to encompass self-employed persons, holders of retail franchises, individuals who work for successive employers on short-term contracts, and employees in enterprises without a plan or in SMEs too small to sustain one. Many of these individuals belong to voluntary organizations, professional bodies or other associations that might be prepared to function as an "affinity group" for the delivery of pensions, as they do presently for the purchase of life insurance and other benefits. "Affinity" plans might operate in a fashion somewhat akin to the Quebec MFPPs, described above. However, such an approach would require amendment of the *Income Tax Act*, which presently requires that the sponsor–member nexus be based on an employment relationship.

What all of these proposals have in common is that they seek to expand access to affordable pensions to individuals who do not now enjoy it. This can be done economically only if sponsors or other pension providers can aggregate their funds into large pools of investment capital, reduce the cost of investment advice, lower administrative expenses, spread the investment risk and the longevity risk across a significant plan population, and provide members with the ability to project their retirement income with reasonable certainty (albeit subject to some degree of risk). This last point is of special importance in plans that offer target benefits, as almost all of the possibilities outlined above will do. If target benefits are provided, the risks associated with this type of plan must be transparent to all participants.

> **Recommendation 9-3** — Legislation and regulations should be enacted to enable and promote large commingled target benefit plans that might provide affordable pension coverage to Ontarians who do not presently have pensions or for whom the costs of obtaining a pension are unnecessarily high.

The effect of these innovations in plan design could be further enhanced by adopting legislation that, when a pension plan is available in a given workplace, participation should be mandatory and automatic, subject to the right of a worker to opt out. Recent experience in the United States suggests that this "nudge" strategy — previously mentioned in Chapter Eight — may significantly increase participation rates. The U.S. experience should be monitored to see whether it is, in fact, as positive as it initially seems to be. If it is, Ontario should consider enacting similar legislation.

Finally, I visualize that the role of the proposed Pension Champion will be to put flesh on these admittedly barebones proposals; to test the waters with pension providers, potential plan members and other stakeholders; to devise a legislative framework for this initiative; and to ensure that all of this is accomplished in a manner that supports those ongoing pension plans that would prefer to continue to operate as they had previously.

9.5 Ontario's Long-term Pension Strategy: Stakeholder Views and Additional Possibilities

In concluding this chapter on innovation in plan design, I feel obliged to report that a significant number of submissions raised the possibility that an expanded or two-tier CPP, or a new provincial counterpart plan, might offer many of the advantages that I seek to capture in Recommendation 9-3 for a new strategy to promote large-scale target benefit plans. I was particularly struck by the fact that this idea was raised in different ways in briefs from stakeholders as disparate as the Canadian Federation of Independent Business and the Canadian Labour Congress.

Details varied. Some urged an expansion of the existing CPP structure so as to either increase the benefit (now 25% of the retiree's best 40 years of accruals), or to increase the maximum earnings on which the benefits accrue (now $44,900 — approximately the average wage), or both. Others suggested allowing employers and employees to voluntarily make extra contributions to the CPP (to be invested by the Canada Pension Plan Investment Board) to buy commensurate extra benefits (administered at a low marginal cost within the existing CPP framework). No matter the details, those making these submissions maintained that a public scheme of some sort would enhance pension coverage, improve benefit portability, and contain costs.

I had neither the mandate nor the time nor the resources to investigate the possibility that an extension of the public pension system might complement, supplement or even replace the existing voluntary occupational pension system, which was the focus of my Commission's work. However, it is an idea that clearly deserves careful study over the longer term while efforts to reinvigorate the present system are under way.

> **Recommendation 9-4** — The government of Ontario should investigate the advantages and disadvantages of expanding the mandate of the Canada Pension Plan, or creating a comparable provincial plan, so as to enhance pension coverage, control costs and improve benefit portability.

The idea of expanding the CPP, among others, has attracted considerable interest outside Ontario as well, and proposals are afoot to discuss it at a national "pension summit." I believe that if such a summit does occur, it ought also to explore a broad spectrum of proposals for large-scale, long-term changes in the architecture of the pension system.

> **Recommendation 9-5** — The government of Ontario should support the call for a national pension summit whose agenda should extend to all ideas for significantly expanding pension coverage, including the innovative proposals contained in this report.

CHAPTER TEN – THE FUTURE OF DEFINED BENEFIT PENSIONS AND PENSION POLICY IN ONTARIO

10.1 Introduction

This report has so far concentrated — as my mandate contemplates — on "the importance of maintaining" Ontario's defined benefit (DB) pension system. Accordingly, my analysis and recommendations have focused on improving "the security, viability and sustainability" of that system with respect to some 16 specific issues set out in my terms of reference. However, my mandate does not stop with recommendations designed to "maintain" the present system. I am to concern myself as well with "encouraging and enhancing" the DB system "as an important policy instrument that supports workforce attachment and fosters an entrepreneurial economy…" and to consider "other matters relevant to enhancing the viability of defined benefit plans in Ontario."

10.2 Optimism and Pessimism about the Future of Ontario's Defined Benefit System

10.2.1 The views of experts and stakeholders

In reviewing what I heard from stakeholders and pension experts representing many different disciplines and affiliations, I was struck by two recurring themes. On the one hand, almost everyone agreed that DB pensions are highly desirable for those workers who have access to them; that they are useful to employers seeking to attract and retain workers in the context of tight labour markets; that they form an integral part of the province's strategy for providing income security for retirees; that funds generated by DB plans make a significant contribution to Ontario's capital markets and to its economy more generally; and that DB pensions ought for all these reasons to be encouraged.

On the other hand, most observers acknowledged that the DB system is experiencing serious difficulties; many foresaw its continuing decline unless various problems were "fixed;" and a few even pronounced it as already "on life support" or even "dead." Indeed, even those who were more optimistic about the system were guarded in their predictions and modest in their expectations.

In general, the optimists seemed to feel that improvements in the legislation and the regulatory machinery might slow or arrest the long-term decline in DB coverage, but not — under present conditions and with a voluntary system — that coverage would return to levels reached, say, 30 years ago. Their best hope for stabilizing and reinvigorating the system seemed to involve introducing a new generation of large-scale DB-like plans, on promoting other forms of employment-based retirement savings, or on modifying or abandoning our present voluntary system in favour of one based on some degree of compulsory participation. These last possibilities were often acknowledged — and sometimes welcomed — even by otherwise pessimistic commentators.

That said, not everyone who commented on the present difficulties of Ontario's DB pension system thought that government had an obligation to "maintain" it, let alone to "encourage and enhance" it or to replace it with something similar.

A few presenters at the Commission's hearings seemed to feel that if DB pensions represent an unsustainable burden for Ontario businesses under present economic circumstances, they will be — and should be — abandoned. In a similar vein, others suggested that since DB pensions are no longer available to most private sector workers, taxpayers ought not to be forced to bear the heavy cost of maintaining them in the public sector. Adherents of these two positions converged on the implicit conclusion that businesses, governments and institutions such as hospitals and universities should be allowed to maintain, reconfigure, reduce or eliminate their pension plans as they deem best.

Another group, while implicitly accepting the conclusion that markets ought to determine public policy, focused on the fact that pension plans do in fact originate in market transactions. Individual or collective wage bargains that provide for pensions constitute a tacit or explicit agreement between the parties that some part of the total remuneration package will be deferred until retirement, when it will arrive in the form of a pension. If, in the negotiation of the wage bargain, no arrangement is made for deferred compensation, market forces will presumably ensure that workers' current take-home pay is adjusted to reflect that fact. Of course, having elected to accept a wage bargain that does not include an element of deferred compensation, workers remain free to set aside some part of their extra remuneration in order to buy a pension (or equivalent) for themselves. If they fail to do so, and choose to spend what they earn on current consumption rather than save for the future, they will have only themselves to blame if they experience hardship in retirement.

While I understand, and to some extent accept, the relatively pessimistic forecast concerning the future of DB pensions, I do not accept the "good riddance" verdict on the DB system implicit in the latter two positions. Indeed, "good riddance" is not a position my mandate would permit me to take. My mandate assumes that DB and other occupational pension plans contribute to the economic and social well-being of the province; that the sustainability and coverage of the pension system are therefore matters of public concern; and that the state has an interest in ensuring that occupational pension plans, once established, should be properly funded and administered. These assumptions no doubt explain why I have been asked to recommend measures not only to "maintain" but to "encourage" and "enhance" the present voluntary DB system, even in the face of rather pessimistic predictions concerning its future.

10.2.2 "Fixing" problems

The measures I recommend, of course, depend not only on my mandate, but on my diagnosis of the difficulties confronting the DB system. In Chapter Three I reviewed various explanations for the decline of the system proffered during our hearings and in commissioned research studies: changing labour markets, declining union density, demographic and attitudinal changes, over-regulation and inappropriate legal rules, the so-called "perfect storm" encountered early in this decade by both financial markets and pension funds, and — most seriously — fundamental and incurable flaws in the architecture of the DB system. Having considered all of these explanations, I concluded in Chapter Three that on the basis of the best evidence available, labour market factors and shrinking union density seem to be responsible for most of the decline in DB coverage. In light of this conclusion, there are intrinsic limits to the kinds of recommendations I might make to improve coverage and strengthen the system.

On the other hand, as I note in Chapters Four through Seven, rules relating to funding, surplus ownership and related issues have also contributed to the cost and volatility of DB plans, and hence to their declining attraction to sponsors — while deficiencies in the legal–regulatory framework can threaten the interests of plan members. I therefore make recommendations in these chapters that aim to enhance "the security, viability and sustainability" of the system by "fixing" these problems.

Yet if "fixing" the present system is a necessary step toward "encouraging and enhancing" the DB system, it is not a sufficient step to halt its shrinkage, let alone to stimulate its growth.

10.2.3 Improving coverage: from reform to innovation

So long as our DB system rests on the voluntarism principle, shrinkage will stop and growth will resume only if and when more sponsors choose to maintain their existing plans or to start new ones — whether for their own reasons, to match job perquisites offered by their competitors or under pressure from a union representing their employees. Sponsors are more likely to make such choices, in my view, if they have access not only to familiar plan designs but to new types of plans whose advantages and outcomes approximate those of classical DB plans. And social policy analysts, active and retired plan members and their representatives will more readily support changes to the *Pension Benefits Act* (PBA) if they are convinced that innovative measures are being introduced that will expand coverage without unduly impairing security. The answer seems to be that a new pension system must be developed whose features are comparable, though not identical, to those of the present DB system.

That is why in Chapters Eight and Nine my proposals to increase the attractiveness of the pension system to sponsors focus on innovation. For example, sponsors prepared to adopt the shared governance model that I have termed a jointly governed target benefit pension plan (JGTBPP) would be permitted, like multi-employer and jointly governed pension plans (MEPPs and JSPPs), to provide target rather than defined benefits. "Affinity" plans based on relationships other than employment would make DB or DB-like pensions available to people who are not strictly speaking "employees," or to those whose employer does not presently offer pension benefits. The risk-spreading, investment and administrative capacities of small single-employer pension plans (SEPPs) would be enhanced, their financial results improved, and their costs reduced, by encouraging them to join existing MEPPs or establish new ones, and by enabling them to take advantage of services offered either by large, sophisticated plans — such as the existing JSPPs — or by commercial providers. Existing MEPPS would be expanded by redefining who is eligible for membership or what services they can offer their members. And if prospective sponsors and members are not attracted by these variations on current pension arrangements, new pension designs would be permitted, such as target or contingent benefit plans or cash balance plans. In Chapter Nine I also suggested that large-scale pension systems that depart from the voluntarism principle — which are mandatory or provide default membership with an employee opt-out — are worthy of careful consideration over the long term.

These, in my view, are all sensible suggestions that both the government and the stakeholders ought to consider very carefully. However, not all sensible ideas about reforming the present system are considered on their merits or win acceptance after close scrutiny, nor will innovation designed to encourage wider and better pension coverage occur spontaneously. Ontario's pension system is too complex, too convoluted and, especially, too conflicted. My extensive encounters over the past two years with stakeholders, regulators, professionals, experts, employers, workers, retirees and other members of the pension community lead me to conclude that several important changes in the pension environment are necessary before change can be expected to occur on a significant scale.

10.2.4 Improving the environment for reform, innovation and long-term pension policy development

First, both reform and innovation must be more thoroughly grounded in careful analysis than they now are. Unfortunately, as Chapter Two reveals, the current state of our knowledge about the pension system leaves much to be desired. This must change. It is not only essential to gather statistics more extensively, accurately and promptly than we now do — it is crucial that those statistics should be analysed objectively, that their implications for public pension policy and private pension provision should be weighed carefully, and that information and analysis should be shared with and discussed by the broader pension community. At the very least, if there are to be disagreements about the desirability and feasibility of proposals for reform and innovation in the DB system, the facts about current practices and outcomes should not be in dispute.

Recommendation 10-1 — The government should:

- considerably improve the collection of data concerning all aspects of the pension system;
- regularly produce analyses of pension coverage, the funding status of pension plans, the contribution of pension plans to capital and labour markets, the performance of the pension regulator and other indicators of how Ontario's pension system is working;
- use such analyses to support periodic and ongoing review of pension policy and the regulation of the pension system; and
- make pension data and analysis readily available to stakeholder, professional and academic users.

In Chapters Seven and Eight, and later in this chapter, I review the relative attractions of assigning responsibility for data collection and analysis to either a reconstituted pension regulator or the proposed Pension Champion, or both. While the choice of who ought to be assigned this responsibility remains an important issue, a far more important one is whether someone is doing these things, and doing them well.

Second, the government and the pension community must both become not only habituated but committed to informed and ongoing discussion as the predicate for making change. There are some hopeful signs. As I note in Chapter One, the Ministry of Finance has begun to improve its statistical capacity in the pension field and has appointed a task force to evaluate the analysis and recommendations provided in this report; the Financial Services Commission of Ontario (FSCO) has begun to consider improvements in its regulatory approach; members of the pension community representing both sponsors and plan members volunteered to assist the Commission's work; partisan briefs presented at public hearings and informal comments by stakeholders during our consultations often acknowledged the need to accommodate opposing points of view; and (I have been advised) some influential actors in the pension field have been in touch with each other directly about possible ways to improve the DB system. Moreover, as Kendra Strauss noted in a study for the Commission, Ontario so far retains a relatively "strong pensions culture" as compared to the United States and the United Kingdom, where a much larger proportion of DB plans have been closed, capped or converted to defined contribution (DC) plans.

On the other hand, attitudes originating in those countries are likely to exert an important influence on Ontario's "pension culture" in the future. Strong ties exist among pension professionals from the three countries who often belong to the same international consulting, actuarial or law firms or networks; serve the same clients; read the same books and journals; use the same or similar analytical tools; and adhere to the same, or similar, professional norms. More importantly, investment decisions affecting Canadian subsidiaries and, often, decisions relating to pension plans, are made by their American and (less frequently) British parent companies. Consequently, attitudes shaped by corporate experience and professional practice in the United Kingdom and the United States are likely to end up determining the fate of many Ontario pension plans.

Not that Ontario lacks for home-grown controversy over pension reform. Indeed, controversy over proposed amendments to the PBA and regulations has been quite intense. One result has been that previous governments have been reluctant to update or amend the Act, despite the obvious need to do so, for fear of political consequences. Nor have governments alone become risk-averse with regard to pensions. Two incidents during the Commission's hearings suggest that obstacles to pension reform and promotion are becoming embedded within the conventional wisdom of private sector and professional actors. On one occasion, I was told by a law firm spokesperson that contractual language used to consummate corporate mergers and acquisitions routinely requires the closure or capping of DB pension plans; on another, a representative of a highly respected DB pension plan active in private equity placements told me that it would not invest in firms with ongoing DB plans. If the DB system is to remain viable, and to move forward, significant effort must be devoted to changing the attitudes toward pension reform of both government and private sector stakeholders.

A final problem is that the identity of "stakeholders" is unclear and their mandate or capacity to support changes in the pension system is open to question. No single organization or group of organizations speaks for sponsors or employers; responsibility for pension policy within the labour movement appears to be distributed between central organizations and their affiliates, which have different pension needs and experiences; retirees' organizations are relatively new and have only the mandate they claim for themselves; non-union workers who have, had or want pensions have no single spokesperson of record; and firms of pension professionals and service providers speak only for themselves and not (except when on retainer) for their clients. Moreover, even when organizations can fairly claim to represent significant interests within the pension community, they do not necessarily employ dedicated pension staff who can speak knowledgeably on pension issues whether at a technical level or at the level of policy.

In such a context, to seek to build consensus by promoting informed discussion and positive attitudes within government and among stakeholders must be understood as a very approximate and long-term project. Nonetheless, such an approach must be tried. The alternative is to allow suspicion, misunderstanding and conflict to perpetuate what has become a virtual impasse in the process of reforming Ontario's pension system.

Recommendation 10-2 — A Pension Community Advisory Council should be formed comprising representatives of all significant stakeholder groups together with other interested parties such as professionals, service providers, academic researchers and business and social advocacy groups. It should be provided with access to data and interpretative studies on Ontario's pension system, invited to advise on significant policy initiatives, and used as a forum to promote an informed and ongoing exchange of views on pension issues.

Third, change in the pension system must be regarded as continuous. New conceptual insights and analytical approaches should be rapidly incorporated into thinking about the pension system. New developments in the general economic and social environment — for example, the decline of the manufacturing sector, the apparent persistence of lower long-term interest rates or fundamental changes in investment philosophy — should trigger prompt consideration of new approaches to providing pension coverage and safeguarding pension funds. New pension products should be made speedily available in response to the pressures of supply or demand, or to lessons learned from other jurisdictions. And as a necessary corollary, appropriate new approaches to regulation and governance should be introduced in tandem with these new products.

Given the delays that are inevitable in the legislative process, how can changes in regulation be accomplished with the requisite speed and frequency? One sensible strategy — already widely used in the pensions field — is to empower the Minister responsible for pensions, or the regulator, to institute changes by enacting or amending rules or regulations made under the statute, rather than by amending the statute itself. As a corollary, those who will be affected by new rules and regulations should — except in emergencies — have an opportunity to contribute to their formulation.

Recommendation 10-3 — The *Pension Benefits Act* and regulations should be drafted in such a way that changes can be made with all deliberate speed to facilitate the introduction of new types of pension plans, to enable rapid regulatory responses to significant changes in the social and economic environment, and to safeguard the interests of sponsors and plan members.

Significant changes in pension law should be accomplished through regulation-making. Except in emergencies, the process of regulation-making should provide for timely notice to and comment by stakeholders and other interested parties, and for advice by the proposed Pension Community Advisory Council.

Finally — especially if continuous change becomes a feature of its pension system — Ontario should not again find itself in a situation where 20 years elapse between comprehensive reviews of its pension law and policy. Too many things can go wrong; too many interests can become vested; too many opportunities can be missed; too many misconceptions can take root; too many lines in the sand can be drawn.

Recommendation 10-4 — Ontario's pension policy, legislation and performance should be comprehensively reviewed every eight years.

10.3 Making Change Happen: A Pension Champion for Ontario

At least so long as the voluntarism principle continues to remain a central pillar of Ontario's pension system, new initiatives will depend to a significant extent on the pension community itself. But this does not mean that government is — or can afford to be — a mere onlooker. Government establishes a policy and regulatory framework that can facilitate change (or frustrate it); it creates, staffs and empowers a regulator whose responsiveness (or lack thereof) may build momentum (or cause gridlock); and it constructs or countenances broader public sector pension plans that may set good examples (or bad ones). Above all, government engages constantly, closely and cooperatively with the pension community (or not).

In my view, benign neglect or "hands off" is not an appropriate stance for government to take vis-à-vis the pension system. Engagement is essential in a voluntary system where individual sponsors and service providers, and in some cases unions, will be the primary moving parties. Only through engagement can government introduce new ideas for consideration by the stakeholders, bring new actors to the table, and conduct studies that will provide a foundation and context for stakeholder initiatives. Only through engagement can government facilitate innovation, mediate divergent interests, ensure that the general direction of change is in the public interest, and make appropriate and speedy changes in the statute or regulations in the interests of both sponsors and members.

But who will engage on government's behalf? Who will speak for government? What person or agency within government is mandated and qualified to work closely with the stakeholders to reinvent the system?

To the best of my knowledge, no official or agency presently plays that role. FSCO has a small policy branch that, in practice, concerns itself exclusively with regulatory issues. The Superintendent of Financial Services has a statutory mandate "to conduct surveys and research programs and to compile statistical information related to pensions and pension plans," and as CEO of FSCO, to "make recommendations to the Minister on matters affecting" the pension sector; but in practice, the Superintendent apparently does neither. The Ministry of Finance has a Pension and Income Security Policy Branch (PISPB) whose broad mandate includes both occupational pensions and other aspects of income security, while other provincial government ministries or agencies — Labour, Economic Development, International Trade and Investment, Community and Social Services, Government and Consumer Services, Citizenship and Immigration, the Seniors' Secretariat — have some interest in pension policy-making as well. However, to the best of my understanding, none of these has adequate data-gathering and analytical capacity, none has a specific mandate to actively promote the defined benefit system or occupational pensions more generally and, in particular, none is presently organized in such a way that it can become proactively involved with the stakeholder community in the manner suggested above.

> **Recommendation 10-5** — Ontario should identify an agency or unit of government as its Pension Champion with responsibility for conducting research into the pension system, for working closely with the stakeholders and the proposed Pension Community Advisory Council, for promoting and facilitating innovation in the pension system and for leading policy development efforts in the pension field.

The questions immediately arise: what will the Pension Champion look like, and where will it be located? These are questions that can be answered only at a high level of generality:

- The Pension Champion should be a high-level agency or unit of government, not a single individual or private sector or academic undertaking.
- It should possess staff resources sufficient to enable it to carry out its assigned functions. Since research would be one of its primary functions, it should have a small but high-quality staff of expert researchers. A second-best solution — because it would not ensure the continuity needed for longitudinal studies — would be to enable the Champion to "buy" research from elsewhere in the government or from academe or the private sector.
- The head of the agency should have the knowledge, skills, experience and stature necessary to secure the attention, respect and cooperation of key pension sector actors as well as government policy makers.

There are good arguments for locating the Pension Champion within the Ministry of Finance:

- The Ministry has had prime responsibility for pension policy and regulation for many years and has reaffirmed its leadership in the field by launching several recent initiatives (including this Commission).
- It is a senior Ministry that is in a position to coordinate many social and economic programs that bear on pension policy.
- Many personnel with relevant skills and experience are already located there.

However, there are arguments to the contrary:

- Locating a Pension Champion at arm's length from the Ministry of Finance would signal a new beginning in pension policy.
- A unit or agency within the Ministry might lack the functional autonomy — and the appearance of autonomy — needed to engage successfully with stakeholders, in regard to such matters as promoting innovative pension plans, consulting with the proposed Pension Community Advisory Council and mediating among conflicting stakeholders.
- Locating the Pension Champion outside of the Ministry of Finance might facilitate liaison with other relevant Ontario ministries, and with counterpart ministries in other provinces, in many of which pensions are not the responsibility of Finance.

While not out of the question, the least attractive location for the Pension Champion would be within the agency responsible for regulating the pension system — either FSCO or its possible replacement, the proposed new Ontario Pension Regulator (OPR). FSCO's basic structure and functions, rather than its current capacities or recent record, suggest that the Champion should be lodged elsewhere:

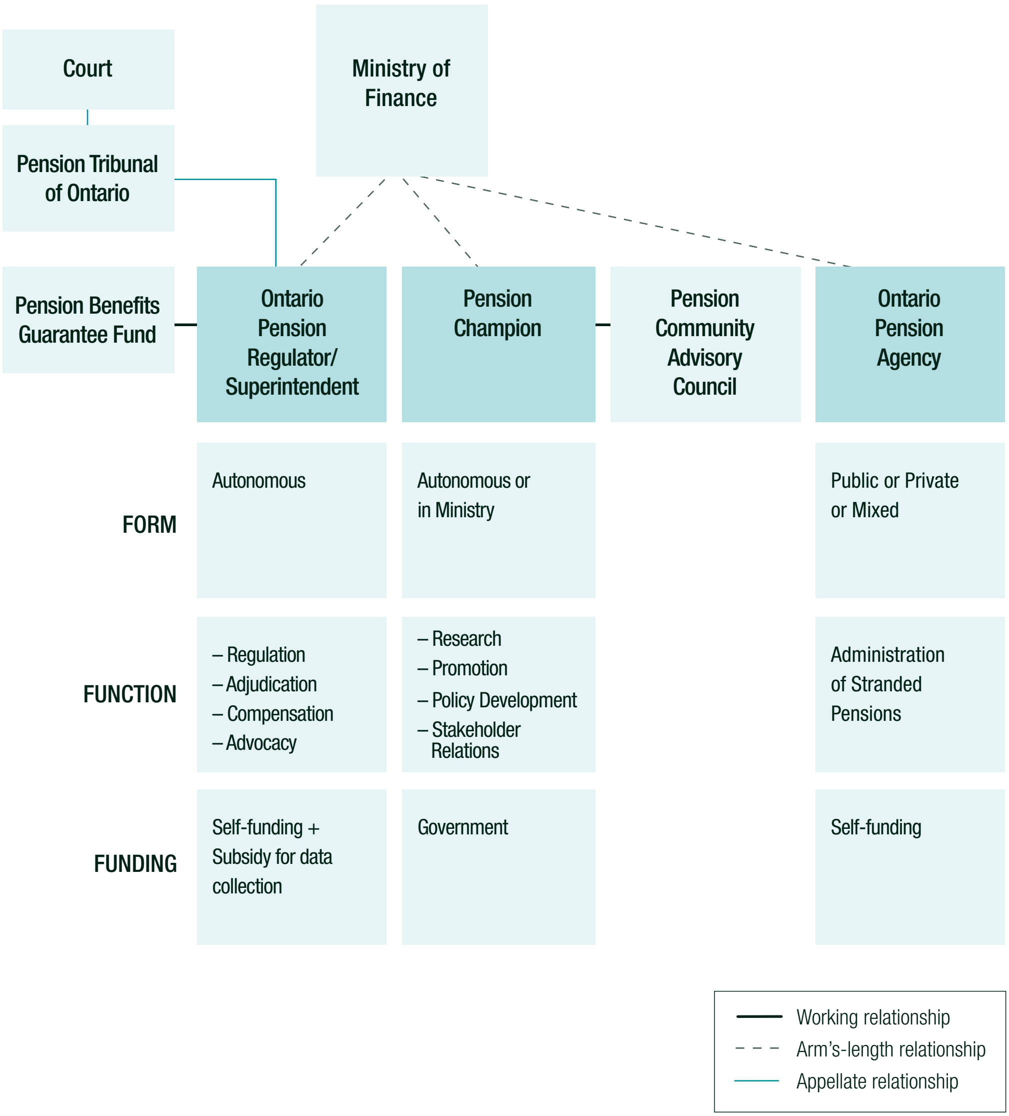
- FSCO was conceived, designed and resourced (however inadequately) as a regulatory agency. Its regulatory functions — often adversarial in character — are not consistent with the kind of close, cooperative working relationship that the Pension Champion ought to develop with the stakeholders.
- FSCO operates on a cost-recovery basis. To place the financial burden of research, stakeholder engagement, interest mediation and policy leadership on the stakeholders themselves potentially provides them with a veto over the extent and nature of such activities, if not their actual outcome.
- FSCO currently has responsibility not just for pensions, but for many aspects of the financial sector such as credit unions and mortgage companies. To assign it a leading role in research and policy development in the pension field alone would be anomalous. (Of course, this particular objection would fall away if my recommendation for a stand-alone single-purpose OPR is accepted.)

Wherever the Pension Champion is located, and whatever its form, it is clear that its important functions cannot be undertaken without some cost to the government. It will require strong leadership — someone who commands respect in the pension community as well as in government, who can bring the stakeholders together, who can negotiate non-statutory changes in the pension system, and who can persuade public policy makers and regulators to accommodate such changes. It will also require sufficient high-quality staff with academic and professional credentials — actuaries, lawyers and economists, for example — who will have to be offered higher salaries than appear to be currently paid such individuals in FSCO or elsewhere in the provincial public service. On the other hand, providing adequate resources to the new Pension Champion is not so much an expenditure as it is a prudent investment. If the information base of pension policy making can be improved; if litigation can be avoided, regulatory burdens eased and long-standing disputes among stakeholders resolved; if innovation can be encouraged and new pension vehicles introduced; if the occupational pension system can be revived and expanded; if present and future retirees can be provided with decent retirement income from their own forgone earnings and do not have to be added to the rolls of government-funded income support programs — if all these things happen, even to a limited extent, the benefits will far more than offset the costs.

> **Recommendation 10-6** — The new Pension Champion should be provided with highly qualified and sufficient staff and resources adequate to undertake its assigned functions.

In summary, what is crucial is that the proposed Pension Champion should be located *somewhere*; that it should be properly resourced and empowered; and that it should embark as quickly as possible on the suggested range of activities whose non-performance will continue to frustrate the resuscitation and reform of Ontario's occupational pension system.

Figure 1: Proposed New Structures for the Ontario Pension System



Many of the substantive recommendations in the report will be impossible to implement in the absence of these institutions, or something approximating them.

Finally, my report is accompanied by a memorandum of detailed technical and operational reforms unanimously proposed by my expert advisors. If adopted, these reforms will help to streamline pension regulation and be of great assistance to the stakeholders.

10.4 Harmonization and Policy Coordination

I have mentioned several times the need to coordinate pension policies with other policies, especially federal policies related to income tax and insolvency. I have also referred to the administrative costs and complications imposed on plan sponsors, administrators and beneficiaries as a result of differences among provincial pension regimes. Reducing or eliminating policy conflict between Ontario and the federal government, and of administrative divergence and duplication among provincial and federal pension regulators, would greatly assist the smooth operation of the pension system.

That said, divergences in policy and regulatory approaches among various jurisdictions are not always the by-product of Canada's federal system. At the highest level, to be sure, they may reflect differences in provincial economies, political perspectives, policy logics or ministerial mandates. At the level of detail and procedure, however, they may reflect nothing more than the capacity and experience of local regulators, the desire to resolve particular local problems or the literary preferences of local legislative draftspersons. In either event, policy coordination will always be extremely difficult to achieve, and detailed regulatory requirements only a little less so.

Nonetheless, I feel obliged to address the issues of coordination and harmonization for several reasons. First, they were raised frequently at the Commission hearings and during stakeholder discussions, both as distinct subjects and, implicitly, when stakeholders proposed improvements in provincial regulation that would require federal legislative changes. Second, they have been the subject of ongoing, if intermittent, initiatives by various organizations in which Ontario representatives participate, including, most recently, the Joint Forum of Financial Market Regulators (JFFMR). Third, pension legislation has recently been or is presently being reviewed in Quebec, British Columbia and Alberta (jointly), Nova Scotia, Ontario and in the federal jurisdiction — half the provinces and a significant majority of Canadian pension plans, sponsors and members. And finally, meetings of provincial and federal Ministers responsible for pensions have not been held for some time.

The time is right — indeed overdue in my opinion — for pension Ministers to meet and address at least a limited agenda of measures related to harmonization of pension laws and regulatory regimes, and to the adjustment of federal laws to better coordinate with provincial pension policies.

> **Recommendation 10-7** — The Minister of Finance for Ontario should promote and support a meeting, at the earliest feasible date, of provincial and federal ministers responsible for pension issues with a view to discussing:
>
> - the possible implications of further divergence in provincial pension policies, legislation and regulatory arrangements if, as and when the recommendations in this report, and in the reports of other provincial pension commissions, come forward for consideration, enactment and implementation by the governments involved;
> - the need for the provinces to act collectively in order to secure changes in federal legislation, particularly the raising of pension contribution limits under the *Income Tax Act* and the more favourable treatment of pension plans and members under federal bankruptcy and insolvency legislation; and

- the potential for some greater standardization of procedural and technical requirements in provincial pension legislation, in light of recommendations contained in the reports of the three current pension commissions and an anticipated report from the Canadian Association of Pension Supervisory Authorities.

The Minister of Finance — the Minister responsible for pensions in Ontario — bears ultimate responsibility for coordination of the province's pension policy and for its contributions to the harmonization of pension regulation across Canada. Of course, the Minister must depend for advice on at least three sources — the Ministry's PISPB, which has primary responsibility for policy development regarding pensions; FSCO, the pension regulator responsible for the day-to-day administration of pension legislation and a member of both the Canadian Association of Pension Supervisory Authorities (CAPSA) and the Joint Forum of Financial Market Regulators (JFFMR); and the proposed Pension Champion, which will be closely engaged with the stakeholders and mandated to identify and promote changes in their interest and in the public interest. One of these, or all acting in concert, should be given the responsibility of supporting a timely initiative by the Minister, and a clear mandate to seize the moment to promote harmonization and policy coordination. It is a moment that will not likely come again soon.

A final word: harmonization and coordination are highly desirable, but they are not more desirable than making the right decisions about Ontario's pension policies and legislation. In fact, making the right decisions for Ontario may hasten harmonization in three ways: first, because this report has identified and drawn upon important innovations in other Canadian jurisdictions; second, because the demonstration effect of well-conceived and well-administered Ontario legislation is likely to influence regulatory regimes in those jurisdictions; and finally, because a significant plurality of active and retired members across the country is already enrolled in plans based and regulated in Ontario. Thus, Ontario should do its best to reach consensus with other jurisdictions, and should spare no effort in removing inconsequential and irritating differences among Canada's regulatory regimes — but in the end, it should act in accordance with what it deems to be good pension policy.

10.5 Getting from Here to There

This report provides a lengthy and ambitious agenda for change in the already complex system of legal rules governing occupational pensions, summarized above in sections 10.2.2 and 10.2.3. However, it also recommends a number of changes in the regulatory, adjudicative, administrative, consultative and policy making institutions associated with that system. The latter changes are captured in Figure 1, below. Of particular importance are three institutions — the Ontario Pension Regulator, the Pension Champion and the Ontario Pension Agency — each of which has a rather different relation to the Ministry of Finance, performs quite different functions and is funded in a different way. Figure 1 also recapitulates these differences.

In an ideal world, the government and the pension community would quickly consult, agree to some or all of the changes recommended in the report and in the expert advisors' memorandum, and implement them immediately by comprehensively redrafting the PBA. However, for various reasons, this is unlikely to happen as quickly as it might. Some stakeholders are almost certain to object to significant parts of the report on grounds they would describe as "principled." Others, who acknowledge that the overall balance of the report's recommendations is fair, may yet seek to change particular features on "practical" grounds. Others, who may be willing to accept those features in principle, may make their acceptance conditional on the resolution of details that have not been addressed in the report itself.

Consultation is likely to take some time. So, too, is drafting. In its present incarnation, the PBA assumes that single-employer plans — SEPPs — are paradigmatic; but as I have noted several times, an increasing proportion of plan members is actually enrolled in other types of plans. In its present incarnation, the PBA and regulations are exceedingly detailed but, paradoxically — because of the persistence of common law (contract) and equitable (trust) doctrines — still radically incomplete. Translating the PBA into what amounts to a complete code of pension law that provides for the unique treatment of many kinds of plans will be a formidable task. In its present incarnation, the PBA assigns responsibilities to, and confers powers upon, officials, tribunals and agencies whose titles, functions, mandates and resources will have to change considerably under the new dispensation. To repeat: drafting new legislation is likely to take a long time, especially if it is to be done well.

Finally, the report rests ultimately, if not exclusively, on the ability of some public agency — the Pension Champion? the Ministry of Finance? the Regulator? — to alter the dynamic of Ontario's pension system by facilitating and encouraging the introduction of new plan designs and practices, and to improve relationships within the pension community by developing better information and analysis, and undertaking more regular and extensive consultations.

All of this could amount to a prescription for delay. However, in my view, delay must be avoided if at all possible. The time for moving ahead is *now*. The Commission's engagement with stakeholders was extensive and arguably unprecedented; its research represents a significant increment to previous knowledge — though much remains to be done; its review of the issues is comprehensive in scope, if sometimes controversial; and the issues are ripe for resolution.

Certainly, implementation will need to be staged and transitional measures put in place: pension plans organized and funded on some other basis will need time to adapt to the new requirements; pension professionals will have to refresh their understanding of the system and, in some cases, revise their strategies and routines; and personnel to staff the new agencies will have to be recruited, trained and deployed. And of course, some of the positive outcomes being promoted in the recommendations —innovation in plan design, for example — will take years or decades to become manifest. But these inherent delays provide all the more reason to begin to "get from here to there" as quickly as possible.

Recommendation 10-8 — The government should maintain momentum in pension reform by moving as rapidly as possible to determine whether or to what extent it wishes to implement the recommendations in this report. Having established its basic direction, the government should then identify issues for priority treatment. An early priority for the government should be to put in place appropriate agencies and officials who can carry forward the ongoing work of reform.

Recommendation 10-9 — The government should identify recommendations that will require phased implementation as well as transitional measures to allow stakeholders to bring themselves into compliance with the new regulatory regime over some reasonable period of time. However, it should be vigilant to ensure that arguments favouring phased implementation and transitional measures are not used to obstruct reforms that the government believes to be necessary and appropriate.

GLOSSARY

Terms in italics are defined elsewhere in the glossary.

Actuarial Valuation: Pension plan *administrators* must submit an actuarial valuation to the regulator — normally every three years — disclosing the plan's financial status and establishing the level of *contributions* necessary to maintain its solvency. In Ontario, this report must be based on both *going concern* and *solvency* assumptions and be prepared by an *actuary*.

Actuary: Under the *PBA*, an actuary must be a Fellow of the Canadian Institute of Actuaries to be eligible to prepare all actuarial reports, as well as other calculations necessary for the administration of pension plans.

Administrators: Administrators ensure that the plan is properly funded, manage the plan's investments and disburse benefits to retirees. Administrators may seek advice from professionals (actuaries, lawyers and accountants) and engage service providers (insurance companies and financial institutions). They also appoint custodial trustees to hold pension funds separately from any other funds. In many *SEPPs*, the administrator is a committee appointed by the employer-*sponsor*; however, in other SEPPs, as well as in *JSPPs* and in *MEPPs*, active (and occasionally retired) *members*, may be represented on these bodies, and in some instances actually control them. While MEPP boards of trustees must act as plan administrators themselves, the governing bodies of SEPPs and JSPPS may appoint an administrator to administer the plan on their behalf.

Annuity: An annuity is a contract purchased from and guaranteed by an insurance company to provide pension payments to someone for their lifetime. When future pension commitments are covered by such a contract, they are said to be "annuitized."

Ancillary Benefits: *DB plans*, in addition to lifetime pension benefits, may provide ancillary benefits such as bridging benefits and enhanced early retirement benefits.

Commuted Value: *Members* who leave a plan before reaching the age at which they would be entitled to a pension may receive instead a one-time payment based on its commuted value — the current value of anticipated future payments according to approved actuarial assumptions.

Contributions: Contributions to a *DB plan* are payments made in accordance with an *actuarial valuation* in an amount sufficient to ensure that the plan can provide the promised benefits. Contributions are often the sole obligation of the employer or sponsor. However, some "contributory plans" provide that *members* pay a fixed percentage of their wages or a set amount per hour worked, while the employer pays any residual amounts required to maintain the solvency of the plan (but never less than 50% of its cost). In JSPPs, the contributions required of all parties may fluctuate according to the funding needs of the plan.

Contribution Holiday: If an ongoing plan is in *surplus*, with more assets than liabilities, excess assets may be used to offset *contributions* for the *current service costs* of funding ongoing pension accruals. When a plan is using surplus to reduce or suspend such contributions, it is taking a contribution holiday.

Current Service Cost: The current service cost or normal cost of current pension accruals is based on a pension plan's *going concern valuation* and must be paid into the pension fund each year.

Deficiency: Plans are in deficiency or under-funded if they have insufficient assets to meet their anticipated obligations. Generally, when a plan is under-funded, the *sponsor* must eliminate the deficiency by making *special payments*, which are spread (amortized) over a period of years. (Plans with fixed *contributions* may take other measures to address under-funding.)

Defined benefit (DB) pension plans: DB plans promise to provide employees upon retirement with a pension calculated according to some specified formula: a percentage of their career average earnings (CAE plans), or of their average earnings during their final years of service (FAE plans); or a fixed sum per month for each month or year worked (flat benefit plans).

Defined contribution (DC) pension plans: DC plans promise to provide employees upon retirement with a sum representing fixed monthly *contributions* by their employer (and sometimes by the employees as well), plus any return on the investment of these contributions achieved prior to retirement. In many *DB plans*, employees either select from a limited range of investment options or manage the investment of the fund themselves.

Discount Rate: The discount rate is the interest rate used to determine the *present value* of a future stream of pension payments.

Financial Services Commission of Ontario (FSCO): FSCO is responsible for administering a number of the statutes that regulate the financial sector, including the *PBA*. FSCO's chief executive officer and primary regulator is "the Superintendent." FSCO is established under the *Financial Services Commission of Ontario Act*.

Financial Services Tribunal (FST): The FST, established under the *Financial Services Commission of Ontario Ac*t, is an adjudicative body that hears appeals from the Superintendent and decides other pension disputes.

Fully Funded: A plan is fully funded if it has sufficient assets to provide for all accrued benefits.

Going Concern Valuation: This method of pension valuation assumes that the plan will be ongoing and that its assets must be sufficient to meet its liabilities (the pension benefits promised) when they come due in the future. If a plan is under-funded on a going concern basis, it has an "unfunded liability" which must be "amortized" over 15 years. If a plan is over-funded, it has a *surplus*.

Indexation: Pension plans may provide for periodic adjustments to pension benefits (usually post-retirement) according to a formula based on a recognized index such as the Consumer Price Index.

Jointly Sponsored Pension Plan (JSPP): JSPPs are *DB plans* in which the employer or employer representatives and the *members* share responsibility for its funding and governance. JSPPs may be either *MEPPs* or *SEPPs*.

Members: The members of pension plans are "active" if they are accruing benefits on a *current service* basis and "deferred" if they have ceased to be employed and cannot accrue future benefits, but will nonetheless be entitled to a pension on reaching their normal retirement age. Under the PBA, members who have retired and are receiving pensions are referred to as "former members." Often the active, deferred and retired members of a plan are collectively identified as "beneficiaries."

Multi-employer Pension Plan (MEPP): MEPPs are pension plans covering workers employed by a number of employers, usually in the same economic sector. They are customarily funded by fixed *contributions*; in the event these contributions are insufficient to pay for the benefits provided, the benefits may have to be reduced. MEPPs are administered by boards of trustees at least 50% of whom must represent the active *members* of the plan. MEPPs in which funding and governance are both shared with the members may qualify as *JSPPs*.

Minister of Finance: The Minister of Finance is the minister responsible for pension policy and regulation in Ontario.

Occupational pension plans: Occupational or workplace pensions are provided by employers to their employees either pursuant to a collective bargaining agreement, or because the employer believes that having a pension plan will assist it in attracting or retaining workers. However, employers are not required by law in Ontario to provide such pensions. By contrast, all workers and employers must contribute to and are covered by the Canada / Quebec Pension Plan. The two main models of occupational pension plans are *DB plans* and *DC plans*. Many variants and hybrids also exist.

Pension Benefits Act (PBA): The PBA is the legislation governing pension plans for *members* employed in workplaces that come under Ontario's legislative jurisdiction. Workers under federal jurisdiction or the jurisdiction of other provinces are covered by different statutes.

Present Value: The present value is the value today of an amount that is to be paid in the future. In relation to *DB plans*, it is used in the context of valuing future promised benefits for funding purposes or portability options.

Single-employer Pension Plan (SEPP): SEPPs are pension plans sponsored — and often administered — by a single employer. SEPPs in which funding and governance are both shared with the *members* may qualify as *JSPPs*.

Solvency Valuation: This method of pension valuation assumes that the plan is about to be wound up so that its assets will have to be used immediately to meet its existing liabilities. If there are more liabilities than assets, the plan has a "solvency *deficiency*" which must be paid over five years. If a plan has greater assets than liabilities on a solvency basis, it has a *surplus*.

Special Payments: Special payments are required for unfunded liabilities and solvency *deficiencies*, as opposed to *current service costs*.

Sponsor: The sponsor of a pension plan offers the plan to employees and is responsible for ensuring that the promised benefits are paid for. In SEPPs, the sponsor is the employer while in JSPPs, the employer or employers and *members* are both sponsors.

Surplus: Plans are in surplus or over-funded if they have more assets than required to meet their anticipated obligations.

Target Benefit Pension Plans: Target benefit pension plans aim to provide a defined benefit but are funded through fixed *contributions*. If the fixed contributions are insufficient to provide the target benefits, the benefits may be reduced. *MEPPs* are typically target benefit plans.

Wind-up: Under the *PBA*, a pension plan wind-up occurs when the plan is terminated and all assets are distributed. A "partial wind-up" may occur when a significant element of the workforce is terminated, or a particular function or workplace is abandoned.

APPENDIX ONE – TERMS OF REFERENCE

Mandate

The Government of Ontario is establishing an Expert Commission to examine the legislation that governs the funding of defined benefit pension plans in Ontario, the rules relating to pension deficits and surpluses, and other issues relating to the security, viability and sustainability of the pension system in Ontario. The Minister of Finance will appoint a Chair of the Commission and an expert and representative Advisory Panel to assist the Chair in his or her deliberations.

The Chair of the Commission will be authorized, with the assistance of the Advisory Panel, to prepare a report to the Minister of Finance that will be guided by the following key principles, take into account the following factors and make recommendations on the following issues:

Guiding Principles

The Expert Commission should observe the following principles to guide the process:

- 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; and
- the impact of demographics and the changing nature of the workforce on the provision of employment pensions.

Factors to Consider

The Expert Commission should consider the following factors in its deliberations:

- the need to encourage the appropriate funding of pension plans and acknowledge the connection between surplus and funding;
- recent case law and its implications for employers, plan members and pensioners;
- the need to avoid costly litigation regarding pension surplus issues;
- the desirability of facilitating negotiations between employers, plan members and pensioners, and balancing their interests in the surplus withdrawal process;
- the risks and obligations assumed by employers, plan members and pensioners in defined benefit pension plans;

- developments in other Canadian jurisdictions and the harmonization of pension laws in Canada; and
- that recommendations should be practical, affordable and implementable.

Issues to be Addressed in the Report

Pension plan funding:

1. the adequacy of regulatory tools, existing reporting rules and timing of required actuarial valuations
2. the rules governing the payment of going concern unfunded liabilities and solvency deficiencies
3. the effect of indexation and other non-pre-funded benefits on a plan's funded status
4. the impact of funding rules on the Pension Benefits Guarantee Fund
5. the funding of multi-employer pension plans

Pension plan surplus:

6. surplus rights and deficit obligations
7. surplus distribution from defined benefit pension plans on full and partial wind up, and from continuing plans
8. reductions or suspensions of contributions (contribution holidays) to defined benefit pension plans

Pension Benefits Guarantee Fund:

9. coverage, assessments and allocations from the fund
10. its role in providing security of pension benefits to plan members and its continuing viability

Pension plan wind-ups:

11. benefits added by law
12. the determination of a partial plan wind-up
13. plan wind-ups when an employer is in deficit
14. unlocated beneficiaries

Pension plan splits and mergers:

15. the allocation of plan surpluses and deficits following mergers and divestments

16. pension asset transfers involving groups of employees

General:

17. pensions as an important policy instrument that supports workforce attachment and fosters an entrepreneurial economy

18. any other matters relevant to enhancing the viability of defined benefit pension plans in Ontario

The Proceedings of the Expert Commission

The Chair of the Expert Commission shall, as part of his or her review, engage in public meetings or hearings and solicit written input from a wide range of interested stakeholders or their representatives on issues affecting the reform of Ontario's regulatory pension framework.

The Chair of the Expert Commission will meet on a regular basis with the Advisory Panel. The Chair may obtain paid advice from actuarial, legal and financial experts, and may commission research papers, as required. The Chair will have staff to assist with the consultation process, coordinate research projects, assist in the drafting of recommendations and perform other required duties.

If requested by the Chair of the Expert Commission, the Deputy Minister of Finance and the Superintendent of the Financial Services Commission of Ontario will assist the Chair and the Advisory Panel in carrying out their duties and functions.

Term of the Chair and Advisory Panel

The Chair and the Advisory Panel will conduct this review from the fall of 2006 to the summer of 2008.

Deliverables

The Chair will provide:

- regular updates to the Minister of Finance; and
- a final report to the Minister, due summer 2008 or such later date as the Minister may approve.

APPENDIX TWO – COMMISSIONER, ADVISORY PANEL AND COMMISSION STAFF

Commissioner

Harry W. Arthurs

University Professor Emeritus, former Dean of Osgoode Hall Law School (1972–77) and President of York University (1985–92), Harry Arthurs has recently completed his assignment as Commissioner appointed to review Federal Labour Standards legislation (2006).

Professor Arthurs is a former member of the Economic Council of Canada, former Bencher of the Law Society of Upper Canada, former President of the Canadian Civil Liberties Association and a former Associate of the Canadian Institute for Advanced Research. He is a Fellow of the Royal Society of Canada, a Corresponding Fellow of the British Academy, Canada Council Killam Laureate in Social Sciences (2002), and winner of the Bora Laskin Award for Contributions to Labour Law (2002) and of the International Labour Organization Decent Work Research Prize (2008). He also holds numerous honorary degrees.

His publications range widely over the areas of labour and administrative law, legal education and the legal profession, globalization, and constitutionalism. He has been an arbitrator and mediator in labour disputes, has conducted inquiries and reviews at Canadian, British and American universities, and has provided advice to governments on a number of issues ranging from higher education policy to the Constitution to labour and employment law.

Advisory Panel

Bob Baldwin

Bob Baldwin is an Ottawa-based consultant who specializes in pensions, aging society and labour market issues. He is a Senior Associate with Informetrica Ltd. and an Adjunct Research Professor in the School of Public Policy and Administration at Carleton University.

Mr. Baldwin was Director of Social and Economic Policy at the Canadian Labour Congress (CLC) from 1995 to 2005 and was the CLC's pension specialist from 1977 to 2005. In that capacity he dealt with the full range of public policy issues with respect to pensions (regulations and tax rules governing workplace pensions; design and role of public pensions). He also bargained pension arrangements and served as a pension plan trustee.

He remains active on pension issues in a consulting capacity. He also serves as a Director of PSP Investments; he is a member of the Committee on Professional Conduct of the Canadian Institute of Actuaries; he also acts as a pension advisor to the Trade Union Advisory Committee of the Organisation for Economic Co-operation and Development.

Kathryn Bush

Kathryn Bush practises in the Pension and Employee Benefits Group in Blakes' Toronto office and is involved in all aspects of income tax and pension and employee benefits law. In the pension and employee benefits area, Ms. Bush is involved in pension plan and employee benefit plan creation, drafting, amendment, governance and funding issues, as well as dealing with corporate reorganizations and their effect on pensions and benefits, and providing opinions in relation to all aspects of pension and benefits law. In the income tax area, a substantial portion of her practice is devoted to executive and deferred compensation planning areas, including stock compensation, salary deferral arrangements, retirement compensation arrangements, supplemental pension plans, retiring allowances, profit sharing plans, cross-border issues and corporate reorganizations.

Ms. Bush is a former Vice-Chair of the Financial Services Commission of Ontario, a former Vice-Chair of the Financial Services Tribunal and a former Vice-Chair of the Pension Commission of Ontario. She is cited in *The Canadian Legal Lexpert Directory* as a "leading practitioner" in pension and benefits law and is listed in the *Canadian Who's Who*.

Ms. Bush has written on a wide range of topics in the areas of income taxation and pension and employee benefits. She is a member of the Canadian Tax Foundation, Canadian Bar Association and Canadian Pension Conference; has been the co-editor of the Canadian Bar Association newsletter on pensions and benefits; has taught for a number of years at the Law Society of Upper Canada's Bar Admissions and continuing legal education courses; and has chaired and spoken at numerous conferences in Canada.

Murray Gold

Murray Gold practises in pension and employee benefits and related insolvency law. He works in all facets of the pension and benefits sector and has been at the forefront of the advancement of jointly trusteed pension and benefit plans for public sector employees. He has advised in regard to the development and establishment of jointly trusteed public and broader public sector plans in Newfoundland and Labrador, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia.

He has also been closely involved with the pension insolvencies at both Air Canada and Stelco, and advises in regard to corporate governance issues of concern to institutional pension investors. He is Canadian counsel to the class plaintiff in the U.S. securities class action complaint against Nortel Networks.

Mr. Gold is the head of the Pension and Benefits department at Koskie Minsky. He is a member of the expert group constituted by the United Nations Economic Programme finance initiative in regard to environmental, social and governance issues. He is also former Chair of the Legal Advisory Committee to the Financial Services Commission of Ontario, and past chair of both the Canadian Pension and Benefits Section of the Ontario branch of the Canadian Bar Association , and the Ontario Region of the Canadian and Pension Benefits Institute. He is also a former director of the Employee Stock Ownership Plan Association of Canada.

Currently, he writes a regular legal column for Benefits Canada. Mr. Gold has lectured at the Pension Investment Management School, co-sponsored by the Schulich School of Business, at the University of Toronto School of Continuing Education for the Certified Employee Benefit Specialist course, and has spoken at numerous industry conferences sponsored by the Law Society of Upper Canada, Insight, the Canadian Institute, Infonex and the International Foundation of Employee Benefit Plans. Mr. Gold received an AB from Harvard University and an LLB from the University of Toronto.

Ian Markham

Ian Markham is a Director of Pension Innovation, Watson Wyatt Canada, in Toronto. He specializes in strategic advice in the full spectrum of retirement consulting services, including financing, design, demographic, governance and administration; conventional and alternative plan designs; as well as registered retirement savings plans and executive pension arrangements. He has served as an advisor for several committees and think tanks for professional, industry and regulatory issues.

He has 30 years of experience in the actuarial, pensions and benefits fields. He coordinates the development in Canada of Watson Wyatt's pension-related innovation, tools and research; serves as lead actuary and client relationship manager for several major clients; is involved in past and current leadership positions within the Association of Canadian Pension Management, the Retirement Income Coalition, and the Canadian Institute of Actuaries; and has had numerous speaking engagements.

Staff

Simon Archer, Senior Research Associate

Simon Archer is a lawyer and PhD candidate at Osgoode Hall Law School. Simon practises pension and securities law; his doctoral research focuses on contemporary problems in Canadian corporate law. He is a former member of the Executive of the Pension Committee and member of the Securities Sub-Committee of the Ontario Bar Association. Mr. Archer has been Adjunct Faculty at Osgoode Hall Law School and the Department of Political Science, York University, a member of the Canadian Association of Labour Lawyers, delegate to the Canadian Association of Pension Supervisory Authorities Model Law Committee, Clerk to the Justices of the Court of Appeal of Ontario and researcher for the Law Commission of Canada. He has published and spoken in the area of pensions and benefits, financial institutions, capital markets and corporate governance. Simon holds a BA and MA from the University of Toronto and an LLB from Osgoode Hall Law School, and is a former Social Sciences and Humanities Research Council Canada Graduate Scholar.

Robert L. Brown, Director of Research

Rob Brown graduated from the University of Waterloo in 1971 with a BMath degree. He added an MA in Gerontology in 1994 (Waterloo) and a PhD in Gerontology from Simon Fraser University in 1997. Professor Brown is a Fellow of the Canadian Institute of Actuaries, a Fellow of the Society of Actuaries (SoA), an Associate of the Casualty Actuarial Society and an Honorary Fellow of the British Institute of Actuaries.

Professor Brown was President of the Canadian Institute of Actuaries in 1990–91 and was President of the SoA in 2000–2001. He is now Chair of the International Actuarial Association's Social Security Committee and sits on its Executive Committee.

Professor Brown has authored six books including *Economic Security for an Aging Canadian Population* (1999). He has published 45 articles in refereed journals. His research focus is the evolution of financial security programs in times of rapidly shifting demographics. More particularly, his main interest is the financing of social security and health care in an aging population.

Professor Brown is currently Professor of Actuarial Science and Director of the Institute of Insurance and Pension Research at the University of Waterloo.

Isla Carmichael, Director of Policy

Isla Carmichael, most recently post-doctoral fellow at the Ontario Institute for Studies in Education of the University of Toronto (OISE/UT), was the Project Manager of Pensions at Work, funded by the Social Sciences and Humanities Research Council of Canada. Her second book on pensions, *Pension Power: Unions, Pension Funds, and Social Investment in Canada*, was published in 2005. She also co-edited the publication *Money on the Line: Workers' Capital in Canada* (Canadian Centre for Policy Alternatives, 2003). She completed her doctorate at OISE/UT in 2000. Her dissertation received the Graduate Prize for Outstanding Research by the Policy Research Initiative of the Government of Canada. Over the previous 17 years, she occupied a number of senior positions at the Ontario Public Service Employees Union, specializing in social and economic policy. Dr. Carmichael has extensive experience teaching at both graduate and undergraduate levels. She is a labour appointee to the Investment Committee of the Canada Post Pension Plan.

Cynthia Crysler, Counsel

Cynthia Crysler received an honours BA from the University of Toronto and an LLB from the University of Western Ontario. While at Western, she was awarded the Aird & Berlis prize in contract law and was on the Dean's Honour List. She was called to the bar in Ontario in 1996 and became a solicitor of England and Wales in 2000.

Ms. Crysler articled and practised law at a national law firm in Canada, specializing in a wide variety of pension matters. During that time she wrote articles for a number of pension and benefits publications. After completing an LLM from University College London with merit and receiving the Jeremy Bentham Scholarship, she worked for Hammond Suddards in London, England, focusing on pension litigation. Upon her return to Canada, Ms. Crysler began working with the Ontario Ministry of Finance as a Senior Policy Advisor, providing policy advice on pension matters. She also co-authored the chapter on Canada in *Tolley's International Pensions and Benefits*.

Margot Nielson, Manager

Margot Nielson has an honours BA in Economics from Glendon College, York University, and worked in the investment industry for a number of years before joining the Ontario government. Ms. Nielson was the manager of the Teachers' Pension Plan Unit in the Ministry of Education, which had responsibility, with the Ontario Teachers' Federation, for developing plan policy for the Ontario Teachers' Pension Plan. She was also a member of the Teachers' Pension Plan Partners' Committee. Before joining the Ministry of Education, Ms. Nielson was an economist with the Ministry of Municipal Affairs and the Ministry of Finance.

Mindy Noble, Research Associate

Mindy Noble graduated from McMaster University in 1999 with an honours BA in sociology and a minor in international justice and human rights. She was awarded an LLB from the University of Toronto in 2002 and received a Gordon Cressy Award for student leadership at that time. Subsequent to her graduation from law school, Ms. Noble worked as a clerk of the Superior Court of Justice in Toronto. She was called to the bar in Ontario in 2003. She has also worked as an associate at a small law firm and as a researcher and editor and has published in the areas of disability rights and trial procedure.

APPENDIX THREE – CONSULTATIONS AND SUBMISSIONS

List of Stakeholder Organizations, Corporations and Individuals Consulted by the Expert Commission

ACS/Buck Consultants

AON Consulting

Association of Canadian Pension Management

Association of Municipalities of Ontario

Blake, Cassels & Graydon LLP (Now called Blakes)

Canada's Association for the 50 Plus

Canadian Auto Workers

Canadian Bar Association

Canadian Institute of Actuaries

Canadian Labour Congress

Canadian Federation of Independent Business

Canadian Federation of Pensioners

Canadian Institute of Actuaries

Canadian Labour Congress

Canadian Manufacturers & Exporters

Canadian Union of Public Employees

Colleges of Applied Arts and Technology Pension Plan

Communications, Energy and Paperworkers Union of Canada

Congress of Union Retirees of Canada

Council of Ontario Universities

Financial Executives International Canada

Financial Services Commission of Ontario

GE Canada

General Motors Canada

Great-West Life Assurance Company

Hospitals of Ontario Pension Plan

International Association of Machinists and Aerospace Workers

Koskie Minsky LLP

London Life Insurance Company

Hugh Mackenzie

Mercer

Ministry of Finance

Ministry of Government Services

Morneau Sobeco

Multi-Employer Benefit Plan Council of Canada

National Pensioners and Senior Citizens Federation

Ontario Bar Association

Ontario Chamber of Commerce

Ontario Confederation of University Faculty Associations

Ontario Federation of Labour

Ontario Municipal Employees Retirement System

Ontario Pension Board

Ontario Public Service Employees Union

Ontario Teachers' Pension Plan

Ontario Teachers' Pension Plan Board

OPSEU Pension Trust

Hugh O'Reilly

Osler, Hoskins & Harcourt LLP

Pension Investment Association of Canada

Towers Perrin

Watson Wyatt

United Food & Commercial Workers

United Steel Workers

II. Briefs and Submissions Received by the Expert Commission

Acker, R.

ACS/Buck Consultants — Toronto

ACS/Buck Consultants — Ottawa

Actuarial Solutions Incorporated

Advocis

Air Canada Pionairs

Ambachtsheer, Keith

Andrews, Doug

Anglican Church of Canada General Synod Pension Plan

Aon Consulting

Association of Canadian Pension Management

Association of Management, Administrative and Professional Crown Employees of Ontario

Association of Municipalities of Ontario

Bakery, Confectionery, Tobacco Workers and Grain Millers International Union — Local 154

Bell Pensioners' Group

Benedek, Peter

Blake, Cassels & Graydon LLP (Now called Blakes)

Boudreau, Suzanne

C. D. Howe Institute

Canada's Association for the Fifty-Plus

Canadian Auto Workers (CAW)

CAW — Local 444/195

CAW — Canada Retired Workers' Advisory Executive

CAW — Local 27 (London Chapter)

Canadian Bankers Association

Canadian Blood Services Defined Benefit Pension Plan Trustees

Canadian Federation of Independent Business

Canadian Federation of Pensioners

Canadian Institute of Actuaries

Canadian Labour Congress

Canadian Life and Health Insurance Association

Canadian Union of Public Employees (CUPE) — Local 1750

CUPE — Ontario Division

Chestnutt, James T., and Frank MacTaggart

College and University Retiree Associations of Canada

Colleges of Applied Arts and Technology Pension Plan

Colleges Ontario

Common Front for Retirement Security

Communications, Energy & Paperworkers Union of Canada — Ontario Region

Congress of Union Retirees of Canada

Co-operative Superannuation Society Pension Plan — Bill Turnbull

Council of Ontario Universities

Dalton, John

DuPont/INVISTA Pensioners Association — Canada

Durham Regional Labour Council's Political Action Committee

Eckler Ltd.

Edelist, Ian

Elliott, Kenneth

Federal Superannuates National Association (Now operates as National Association of Federal Retirees)

Financial Executives International Canada

Fox, William

Franklin, Ronald

Galasso. Dr. Peter J.

Grace, David J.

Graphic Communications Supplemental Retirement and Disability Fund of Canada; Graphic Communications Pension Plan of Canada

Gronlund, Mark

H. J. Heinz Company of Canada

Hall, Gordon

Hamilton Specialty Bar Division/Slater Steel Salaried Pensioners Association

Hartwick, John

Hospitals of Ontario Pension Plan

Howe, David F.

Huffman, Richard

Hyde, Earl

International Association of Machinists and Aerospace Workers

Kennedy, Joe

Koskie Minsky LLP

Labourers' Pension Fund of Central and Eastern Canada

Luste, George (University of Toronto Faculty Association)

Mercer

Morneau Sobeco

Multi-Employer Benefit Plan Council of Canada

Municipal Property Assessment Corporation (MPAC)

MPAC Employees

Municipal Retirees Organization of Ontario

Murray, David

National Pensioners and Senior Citizens Federation; Small Investor Protection Association; United Senior Citizens of Ontario

Nursing Homes and Related Industries Pension Plan

Ontario Association of Police Services Boards

Ontario Bar Association

Ontario Chamber of Commerce

Ontario Colleges Retirees' Association

Ontario Confederation of University Faculty Associations

Ontario Crown Attorneys' Association; Professional Engineers Government of Ontario; Association of Law Officers of the Crown

Ontario Federation of Labour

Ontario Ministry of Government and Consumer Services (Now called Ministry of Government Services)

Ontario Municipal Employees Retirement System

Ontario Pension Board

Ontario Professional Fire Fighters Association

Ontario Public Services Employees Union (OPSEU)

OPSEU — Local 552

OPSEU Pension Trust

OPSEU Retired Members Division Region 5

Ontario Secondary School Teachers' Federation

Ontario Teachers' Federation

Ontario Teachers' Pension Plan

O'Reilly, Hugh

Osler, Hoskin & Harcourt LLP

Pension Investment Association of Canada

Pensioners of Slater Steel (A. Miscio and L. Pickett)

Police Association of Ontario

Police Pensioners Association of Ontario

Police Retirees of Ontario Inc.

Retired Academics and Librarians at the University of Toronto — Helen S. Rosenthal, Chair of the Pensions Committee

Ruprecht, J.

Semple, Noel

St. Lawrence College Retirees Association

Shareholder Association for Research and Education

Shepherds' Trust

Social Investment Organization

Stafford, James, Paul Satinder, and Pentti Paularinne

Stanc, Flaviano

Stel Salaried Pensioners Organization

TD Asset Management Inc.

Terminated Salary Employees and Members of the Salary Pension Plan — MAHLE Engine Components Canada

Towers Perrin

Tracey, Ruth

TTC Pension Fund

Union Pension Services Ltd.

United Food and Commercial Workers Union Canada

United Senior Citizens of Ontario

United Steel Workers (USW) — District 6 (Ontario and Atlantic Provinces)

USW — Local 1005

USW — Local 8782

Watson Wyatt Worldwide

Williams, Joann

Workplace Safety and Insurance Board

APPENDIX FOUR – RESEARCH PROGRAM

I. List of Experts Consulted by the Expert Commission in the Development of the Research Program

Keith Ambachtsheer
KPA Advisory Services Ltd.

Jim Armstrong
Bank of Canada

Randy Bauslaugh
Blake, Cassels & Graydon (Now called Blakes)

Steve Bonnar
Towers Perrin

Doug Bruce
Canadian Federation of Independent Business

Gordon Clark
Oxford University

Michael Cohen
(formerly with the Bank of Canada)

Mary Condon
Osgoode Hall Law School, York University

Bob Christie
Financial Services Commission of Ontario

Ronald Davis
Faculty of Law, University of British Columbia

Randy Dutka
(formerly with Watson Wyatt)

The Honourable Justice James Farley
McCarthy Tetrault LLP

Mitchell Frazer
Torys LLP

Richard Freeman
Harvard University, National Bureau of Economic Research

Mark Fuller
Ontario Pension Board

Normand Gendron
ACS/Buck Consultants

Sym Gill
Canadian Auto Workers

Malcolm Hamilton
Mercer

Jo-Ann Hannah
Canadian Auto Workers

Martin Hering
McMaster University

Keith Horner
(formerly with Department of Finance)

Michael Kainer
Sack Goldblatt Mitchell LLP

Ari Kaplan
Koskie Minsky LLP

Nick Le Pan
(formerly with Office of the Superintendent of Financial Institutions)

Tom Levy
The Segal Company

Jinyan Li
Osgoode Hall Law School, York University

Paul Litner
Osler, Hoskins & Harcourt LLP

George Ma
Financial Services Commission of Ontario

Hugh Mackenzie
Consultant

Bruce Macnaughton
Ministry of Finance

Charlene Moriarty
ACS/Buck Consultants

Johh Myles
University of Toronto

Gary Nachshen
Stikeman Elliott LLP

Scott Perkin
Association of Canadian Pension Management

H. Clare Pitcher
ACS/Buck Consultants

William Robson
C.D. Howe

Jack Selody
Bank of Canada

Elizabeth Shilton
University of Toronto

Richard Shillington
Informetrica

David Short
(formerly with Eckler Ltd.)

Byron Spencer
McMaster University

David Stouffer
(formerly with Mercer)

Edward Tamagno
Caledon Institute

Monica Townson
Consultant

Gretchen Van Riesen
Pension Investment Association of Canada

Michael Wolfson
Statistics Canada

James Wooten
University of Buffalo Law School

Terence Yuen
Watson Wyatt

Jayne Zanglein
Western Carolina University

II. Research Projects Undertaken by the Expert Commission with Titles of Studies and Researchers

Project #1: Mapping Coverage and Funding of Occupational Pension Plans

a) *Defined Benefit Occupational Pension Plans: Members and Funding*, Richard Shillington (Informetrica Limited, Ottawa, Ontario)

b) *Occupational Pension Coverage in Ontario*, Richard Shillington (Informetrica Limited, Ottawa, Ontario)

c) *The Fiscal Effects of a Drop in Pension Coverage*, Keith Horner (Consultant, Ottawa, Ontario)

Project #2: Occupational Pension Plans and Retirement Income of Ontarians

a) *Income Security During Retirement in Ontario*, Sebastien LaRochelle-Cote and Garnet Picot (Statistics Canada) and John F. Myles (University of Toronto)

Project #3: Factors Affecting Trends in Occupational Pension Plans in Ontario

a) *Defined Benefit Pension Coverage and Funding in Ontario: Local Experiences in a Global Context* , Professor Gordon L. Clark, Ashby H.B. Monk and Courtney S. Monk (Oxford University Centre for the Environment)

b) *Trends in Occupational Pension Coverage in Ontario*, Kendra Strauss (School of Geography, University of Oxford)

Project #4: Funding Regimes in Comparative Context

a) *Comparative Funding Regimes*, Colin J. Pugh (Organisation for Economic Co-operation and Development, External Consultant)

Project #5: Comparative Models of Regulation of Risk-Based Industries

a) *Comparative Models of Risk-based Financial Services*, Mary Condon (Osgoode Hall Law School, York University)

Project #6: Insurance Against Pension Plan Failure: the Pension Benefit Guarantee Fund and Its Alternatives

a) *Examining Alternative Systems to Guarantee Private Pension Payments*, Norma Nielson (Haskayne School of Business, University of Calgary)

Project #7: An Analysis of Asymmetry and Deferred Wages

a) *Arguments about Asymmetry of Risks and Rewards and Deferred Wages in Pension Plans*, James Wooten (University of Buffalo Law School, State University of New York)

Project #8: Analysis of the Financial Services Commission of Ontario

a) *The Effectiveness and Efficiency of Pension Regulation in Ontario and in Comparative Perspective*, Lorne Sossin (Faculty of Law, University of Toronto)

Project #9: Actuarial Costing Branch

a) *Actuarial Costing Research*, Brian A. P. FitzGerald (Capital G Consulting Inc.)

Project #10: Protecting the Pension Fund

a) *Protecting the Pension Fund*, Ronald B. Davis (University of British Columbia, Faculty of Law)

Project #11: Analysis of Multi-Employer Pension Plan

a) *Current Issues Concerning Multi-Employer Pension Plans in Ontario*, Elizabeth Shilton (University of Toronto)

Project #12: Alternative Governance Models

a) *Vehicles for Collective Provision of Pension Services: Pension Plans For Small and Medium sized Enterprises*, Professor Teresa Ghilarducci (The New School for Social Research, New York)

Project #13: Analysis of Pension Plans in Insolvencies

a) *Analysis of Factors Leading to Insolvency and Restructuring and Their Effects on Pension Plan Wind-ups and Closures*, Janis P. Sarra and Ronald B. Davis (University of British Columbia, Faculty of Law)

Project #14: The Impact of Pension Funds on the Ontario Economy

a) *Pension Funds: Trends in Asset Allocation and Role in Capital Markets Corporate Governance and Regulatory Policy*, Poonam Puri (Osgoode Hall Law School, York University)

Project #15: Pensions Plans and the Labour Force

a) *Incentive Effects of Occupational Pension Plans*, Morley Gunderson (University of Toronto, Department of Economics)

Project #16: Tax Policy and Occupational Pensions Plans

a) *Impact of Tax Policy on Coverage and Funding of Corporate-Sponsored Pension Plans*, Jinyan Li (Osgoode Hall Law School, York University)

b) *Tax Expenditure Analysis of Employer-sponsored Registered Pension Plan*, Jinyan Li (Osgoode Hall Law School, York University)

Project #17: Mapping Pension Legislation (in Canada)

a) *Mapping Pension Legislation in Canada*, Ontario Bar Association

b) Summary o*f Pension Legislation in Canada*, Morneau Sobeco