THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

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Via email: pensionreg@novascotia.ca

Paula Boyd
Superintendent of Pensions
Finance and Treasury Board
Pension Regulation Division
PO Box 2531
Halifax, NS B3J 3N5

Dear Ms. Boyd:

Re: Improved Funding Framework for Nova Scotia Pension Plans: The Road Forward

I write on behalf of the Canadian Bar Association's Pensions and Benefits Law Section (CBA Section) in response to the Nova Scotia Department of Finance and Treasury Board (NS Finance) discussion paper, *Improved Funding Framework for Nova Scotia Pension Plans: The Road Forward* (discussion paper).[1] The discussion paper considers possible changes to the *Pension Benefits Regulations* under the *Pension Benefits Act* (PBA).

The CBA is a national association of over 36,000 members, including lawyers, notaries, academics and students across Canada, with a mandate to seek improvements in the law and the administration of justice. The CBA Section contributes to national policy, reviews developing pensions and benefits legislation and promotes harmonization. Our members are involved in all aspects of pensions and benefits law, including counsel who advise pension and benefit plan administrators, employers, unions, employees and employee groups, trust and insurance companies, pension and benefit consultants, and investment managers and advisors.

Guiding Principles

The CBA Section advocates for four guiding principles in considering potential changes to the funding framework:

1. Sustainability – robustness for changing economic conditions.

2. Clarity – legislative guidance on entitlements to and uses of plan funds.

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[1] Nova Scotia Department of Finance and Treasury Board, Improved Funding Framework for Nova Scotia Pension Plans: The Road Forward (May 2019).

3. Harmonization – alignment with rules in provinces that have undergone solvency funding reform.

4. Retirement Income Security - pension issues are of national importance and improving the funding and security of pension benefits will facilitate a reliable retirement savings system for Canadians.[2]

These principles are reflected in our previous submission to NS Finance and in a CBA resolution.[3] In weighing the proposed funding models, we encourage NS Finance to promote these principles as much as possible in the circumstances.

<u>Feedback Requested</u>

1. Types of employer contributions that should be permitted to be paid into a reserve account

NS Finance's approach to funding reform, which includes the introduction of reserve accounts and significant revisions to solvency funding rules, differs from funding reform initiatives adopted by other provinces. In some provinces, such as Ontario and Quebec, new rules have changed the going concern and solvency funding framework, while in other jurisdictions, such as Alberta, the existing going concern and solvency funding framework has been left largely intact, but solvency reserve accounts (SRA) have been introduced in minimum standards legislation. To date, no other Canadian jurisdiction has adopted an approach which includes reforms to going concern and solvency funding rules as well as reserve accounts. While not problematic in itself, the adoption of both approaches introduces greater variation to funding rules across Canada.

There are differing views in the CBA Section about the merit of adopting SRAs. However, in light of the passage of Bill 109 *Pension Benefits Act* (amended) and its introduction of reserve accounts, which may receive "payments made in respect of a solvency deficiency <u>or other prescribed contributions</u>,"[4] we agree that contributions to reserve accounts should be limited to solvency special payments, and that no further contributions should be prescribed by regulation. This approach would further harmonization as it is consistent with the regulatory scheme in Alberta and British Columbia.

2. Most appropriate going concern provision for adverse deviation/margin

a. Preference of Option 1 over Option 2

Based on the guiding principles we identified, there is no policy-based reason to prefer one option over the other. Each provision for adverse deviation (PfAD) calculation appears to have its own advantages – the interest risk sensitivity of Option 1 or the relative simplicity of Option 2. We encourage NS Finance to implement its chosen option in accordance with the principles of harmonization and clarity.

Based on the PfAD tables presented in the discussion paper, Option 1 appears to generally follow the PfAD provision in the Quebec regulations (QC Regs),[5] while Option 2 appears to follow the Ontario

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2 Canadian Bar Association, Resolution 10-02-M *Funding and Security of Pension Benefits,* February 13-14, 2010.

3 Canadian Bar Association, Pension Funding Framework Review and other issues affecting pension plans (2017); Canadian Bar Association, Resolution 10-02-M *Funding and Security of Pension Benefits,* February 13-14, 2010.

4 Bill 109, Pensions Benefits Act (as amended) at 76(A)(2).

5 Regulation respecting supplemental pension plans, CQLR c R-15.1, ss. 60.6-60.11.

regulations (ON Regs).[6] However, the options presented are not identical to the regulations of either Quebec or Ontario. The Ontario and Quebec approaches appear to have been modified or combined to formulate the two options, but the discussion paper does not explain the motivation for these differences, which could include differences in Nova Scotia demographics or pension plan funding experience, nor does it tie them to the specific changes.

To further harmonization, we recommend that, absent a compelling policy rationale to the contrary, the QC Regs be precisely followed if Option 1 is chosen, and the ON Regs be precisely followed if Option 2 is chosen. This recommendation includes, but is not limited to, the following changes to the options:

- If Option 1 is selected, increasing all the PfAD values in the table on p. 3 of the discussion paper by 5%, in accordance with s. 60.6 the QC Regs;

- If Option 2 is selected, applying a lower fixed PfAD and a lower PfAD scale to open plans, in accordance with ss. 11.2(3) and Table 1 under s. 11.2 of the ON Regs;

- In either option, defining variable income securities in accordance with the respective jurisdiction's regulations. Both jurisdictions have identical minimum bond and money market credit ratings for fixed income securities (s. 60.8 of the QC Regs, Table 2 under s. 11.2 of the ON Regs);

- If Option 1 is selected, providing that asset/liability duration ratio should be calculated by an actuary in accordance with a formula prescribed in the regulations, as defined under ss. 60.9 and 60.10 of the QC Regs; and

- The "additional amount [of PfAD] if the pension plan were to use a discount rate that exceeds a certain level" is not a feature of the QC Regs, and therefore should be added to Option 2, but not Option 1. As noted in the discussion paper, the asset/liability duration ratio is a "measure of interest rate risk"; therefore, such risk is already captured in the columns of the table under Option 1. If Option 2 is selected, the calculation of this amount should adhere to the amount "C" as defined under ss. 11.2(2) and (5)-(12) of the ON Regs.

The presumptive adherence to Ontario or Quebec regulations, including the changes noted above, may be rebutted by a compelling rationale and empirical evidence supporting a different approach in Nova Scotia.

For clarity, we recommend that the table corresponding to the chosen option be sufficiently robust to ensure accurate PfAD calculations no matter the input. Both Ontario and Quebec currently prescribe a linear interpolation of the table values.[7]

b. Other options that should be considered

The CBA Section does not recommend other options.

c. Whether there should be a different PfAD for solvency exempt or public sector plans

The CBA Section believes that solvency exempt and public sector plans should not be subject to a PfAD under the amended regulation. Excepting these plans from the PfAD requirement would not pose a risk

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6 Regulation 909 under the Pension Benefits Act, R.S.O. 1990, c. P.8 at ss. 11.1, 11.2 and related regulations.

7 See s. 60.6 of the QC Regs, s. 11.2(3) of the ON Regs.

to retirement income security, and would promote sustainability by allowing the entities sponsoring these plans to allocate scarce resources to other aspects of their operations instead of pension plans that are relatively stable and secure.

In jurisdictions where they exist, PfADs and similar funding requirements have been introduced as a trade off for less onerous solvency funding requirements. While PfADs may help mitigate the risk of benefit reductions in certain windup situations, this is of minimal benefit to solvency exempt and public sector plans that are unlikely to be wound up.

PfADs are better understood as tools to help moderate the impact of negative plan experiences, such as decreases in discount rates, increases in pensionable earnings and improved mortality, which may increase actuarial liabilities and impact a plan's ability to pay accrued benefits as they come due. In our view, solvency exempt plans, which in Nova Scotia include specified multi-employer pension plans, university pension plans and school board pension plans, are well positioned to withstand the impact of negative plan experiences. This view is supported by findings in the 2018 Report of the Superintendent of Pensions on the Administration of the PBA,[8] which indicates that these plans are generally fully funded on a going concern basis. Sponsors of solvency exempt and public sector plans are also generally able to make higher pension plan contributions if an actuarial valuation reveals greater going concern liabilities.

d. Use of an additional PfAD to apply for pension plans using aggressive discount rates

The discussion paper proposes the use of an additional PfAD amount where a plan's discount rate exceeds the benchmark discount rate set out in Ontario's funding rules. While not identical, this approach would be consistent with the target benefit plan funding regimes of Alberta and British Columbia, which also require a higher PfAD to be used where the discount rate exceeds a prescribed benchmark. Requiring an additional PfAD where a plan uses a discount rate in excess of a pre-determined amount promotes harmonization across these jurisdictions and, to an extent, greater retirement income security. However, as previously noted, the use of an additional PfAD is not contemplated by the QC Regs. If NS Finance adopts Option 1 (revised, as suggested, to reflect the stricter PfAD requirements of the QC Regs), we believe that adopting an additional PfAD for plans that use "aggressive" interest rates would do little to enhance retirement income security and would undermine regulatory harmonization.

e. Definition of variable income securities

The CBA Section has no preferred definition of *variable income securities* given the policy issues involved in choosing a definition. However, in line with the principle of regulatory harmonization, we encourage NS Finance to select a definition aligned with either the QC Regs or the ON Regs, depending on whether Option 1 or Option 2 is adopted for purposes of the PfAD calculation.

Under the Quebec rules, everything except a limited number of exceptions are treated as variable yield investments. These exceptions include cash, money market instruments and bonds that meet minimum credit rating requirements, first or second mortgages that do not exceed 75% of a property's value, and 50% of the value of direct investments in real estate or infrastructure.

Ontario takes a somewhat different approach by categorizing investments as fixed income, non-fixed income, and 50% fixed income, depending on how the asset is held. For example, certain debt can be

8 Nova Scotia Finance and Treasury Board, Pension Regulation Division, Report of the Superintendent of Pensions on the Administration of the Pension Benefits Act for the Year Ending March 31, 2018.

categorized as fixed income if it meets minimum credit rating requirements and be treated as 50% fixed income if it is held through an investment vehicle.

While both approaches are more complex than the approach taken in Alberta and British Columbia (i.e., to treat all investments that are neither listed on a securities exchange nor designated as equities by the applicable regulator as fixed income), we recommend the wholesale adoption of either the Quebec or the Ontario approach to defining fixed income securities since the definition is closely aligned to how the PfAD is calculated. A wealth of regulatory and industry experience already exists in both Quebec and Ontario that would assist pension plan administrators in Nova Scotia in understanding and applying either definition.

3. Proposed three-year transition period

We support a transition period for pension plans whose contribution requirements increase as a result of the new funding regime. A three-year transition period is a balanced approach and aligns with the four guiding principles.

A stated goal of the government is to promote a more stable and predictable regulatory environment for pension plans. In pension plans whose contribution requirements increase as a result of the new funding regime, increases will need to be funded by plan sponsors and, if applicable, plan members. Plan sponsors and members would have planned their financial affairs according to the previous funding requirements. Without a transition period, they may face abrupt and significant impacts. A transition period will improve stability and allow pension plans whose contribution requirements will increase under the new funding rules time to adjust.

The transition period should not be too short as to fall short of providing adequate time for plan sponsors and, if applicable, plan members to adjust nor too long as to frustrate retirement income security or sustainability. A three year transition period offers a balanced approach. It is also consistent with the guiding principle of harmonization as both Ontario and Quebec have already undergone solvency funding reforms, and have effectively used a three year transition period for pension plans that had increased contribution requirements under new funding regimes.

The CBA Section supports starting the transition period at the valuation date of the most recent actuarial valuation, as opposed to the proclamation and coming into effect of the new funding regime. We also support phasing in any contribution increases over a period of three years from the valuation date of the first report filed under the new framework. This method is harmonious with the approach taken in Ontario. It is also reasonable to expect that plan sponsors and, if applicable, plan members, would have planned their financial affairs according to the most recent actuarial valuation requirements, and should be permitted to comply with such valuations. There is also a cost to conducting actuarial valuations; allowing the most recent actuarial valuations to be completed before new valuations are required is more cost effective.

4. Proposed contribution holiday threshold

While the CBA Section takes no position on Nova Scotia's proposal of a contribution holiday threshold of 110% on both the going concern and the solvency basis, we note the following:

- The proposed 110% threshold is higher than other jurisdictions (e.g. 105% in Ontario and Quebec) and we prefer consistency with other provinces.

- The requirements on contribution holidays should be consistent with other jurisdictions, including:
  - the determination of "available surplus";
  - the application of contribution holidays to normal cost contributions, including the PfAD for those contributions, prior to other forms of prescribed funding; and
  - required notices to plan members and unions.

<u>Other Comments</u>

Annuity Buy-outs

We commend NS Finance for amending the PBA to include a statutory discharge for annuity buy-outs from ongoing plans. NS Finance should draft sustainable and clear regulations anticipating issues emerging from purchases of annuities.

Consistent with other jurisdictions that have enacted statutory discharge provisions for annuity buy-outs, we recommend that regulations mandate provisions for family law and non-seizability of assets in group annuity contracts. More precisely, contracts should outline mandatory provisions for annuity contracts regarding exemption from seizure, spouses' rights upon marriage breakdown and beneficiaries, death benefits and the requirement of a certificate of insurance. These regulations would ensure that insurers offer minimum protections to plan members, increase members' awareness of their rights and, by extension, improve retirement income security.

Letters of Credit

Recently modified pension legislation in Quebec and Ontario preserves the 15% cap on letters of credit. While this divergence from other jurisdictions will allow greater flexibility and market forces to determine how much credit is available to an employer to fund solvency deficiencies, the CBA Section recommends that some limitations be set to promote clarity, sustainability and retirement income security. To control the use of this type of financing we suggest that all letters of credit, including those already provided by the employer, should be considered when determining the value of assets on a going concern basis. The government could consider imposing a rule capping the utilisation of letters of credit to the maximum value of the employer's contributions.

We appreciate the opportunity to comment on the discussion paper. We trust that our comments are helpful and would be pleased to offer further clarification.

Yours truly,

(original letter signed by Nadia Sayed for Sonia Mak)

Sonia Mak
Chair, CBA Pensions and Benefits Law Section