



EXCLUSIVE INTERVIEW:

Today I'm pleased to be talking to Ian Markham, Canadian Retirement Innovation Leader with Towers Watson. Ian was also a member of Professor Harry Arthur's Ontario Expert Commission on Pensions which produced the report "*A Fine Balance, Safe Pensions, Affordable Plans, Fair Rules.*"

Our discussion centres on whether the recent pension reform announcements made by Ontario Finance Minister Dwight Duncan will in fact achieve the balance Professor Arthurs was aiming for.

Thanks for joining me today Ian.

Q. Some of this week's announcements were more controversial than others. Are the restrictions on smoothing and the new framework for contribution holidays unexpected or problematic from either an employer or employee perspective?

A. Well let's deal with those two separately.

The smoothing restriction is actually relatively modest. Harry recommended that smoothing be abolished, but of course his report was largely finished before the market crash at the end of 2008. So the restriction that will just curtail the degree to which the smoothed asset values exceed the market values by no more than 20% is I think quite a fair way of proceeding, and I don't think we are going to see much push back on that.

In fact, I think it is definitely a step in the right direction to push a little bit towards market. In the current environment with the market values where they are, we are going to see the ratio of smoothing move towards market for the next little while anyway, so it is probably not going to have much of an impact.

In terms of the framework for contribution holidays and the 5% margin, I think that one was largely unexpected. We've already got something a little more complicated in Quebec. By and large I think most private sector employers were anticipating having something like that, and it does show -- together with benefit improvements -- that there is very much a mood now towards protecting the accrued benefits. If you are going to have a pension plan and promise benefits, do the very best you can to provide those benefits.

To have the 5% cushion I think is a reasonable thing to do, with one caveat. Private sector employers worried about what happens if they put too much money in the plan and it ends up in surplus. This 5% margin is a form of surplus, and employers want to avoid having excess money become "trapped capital,"

There were really two ways prevent this happening..

One is them was in fact proposed, and it is the ability to use letters of credit in lieu of cash contributions up to a certain limit. This is good news for those who have enough credit facility to use them.

The other one is something that wasn't in Harry's report and certainly was not in this announcement, but it was proposed by Alberta/B.C. The concept is a pension security trust where extra money that goes in and is not needed can be refunded to the employer. If Ontario could ever find the ability to move in that direction, it would be something that would make it more palatable for private sector employers to keep their DB plans going.

Q. We haven't seen any legislative proposals yet from the west for the side fund concept.

A. No and I don't actually have any information on how that is proceeding. I sincerely hope that the west will figure out a way of making it work so that it can be an example for other jurisdictions to take a look at and see what the reactions are.

Q. What about accelerating the funding of benefit improvements so they have to be funded over eight years instead of the current 15 years? Will that provision limit the number of plan sponsors that make benefit improvements? Is that a good thing or a bad thing?

A. Well I do think that protecting the benefit promise is very much a part of this reform so I think it is wise to have organizations or parties who are interested in benefit improvements take a hard look at what they can afford. Funding it over eight years is a way of protecting the accrued benefit promise that existed before the benefit improvement. Yes I think it will limit the number of sponsors that make benefit improvements and I think it will also force some of those benefit improvements to be smaller than they have otherwise been. And all of that is to

protect the accrued benefit promise because after the improvement has been made if the market then tanks and is being funded over a 15 year period, then you could have a sizeable deficit left over and it means such a long period of time for the organization to get through until that benefit fully funded.

So I think this is something in the interests of transparency. If you are going to improve the plan, just pay it off over a relatively shorter period of time.

There is one little comment I'll make and that is just that there is something a little odd in the announcement, certainly for private sector companies. They talk about funding over eight years, but then if the transfer ratio or the going concern funded ratio is less than 85, it says, "pay a lump sum in" (and I assume that pushes you up to 85) "and anything else paid over five years." It just seems a little odd that you've got an eight year rule and a five year rule and they didn't really explain how those work. I don't know if we have a discontinuity there but we'll have to hope that the legislation is sensible.

Q. Interesting. Well I know you told me surplus withdrawal is more the forte of the lawyers but do you have any views at all on the proposed new binding arbitration process to deal with surplus on wind up and how the entitlement/consent regime will simplify matters and keep plan sponsors and employee groups out of court?

A. I'll simply say that changing from a requirement to demonstrate both entitlement and consent has got to be an improvement over the current situation so I'm a bit more comfortable with this general direction. Also, mediation does have some merit but I'm going to leave it to the lawyers to comment in more detail on that.

Q. The modified funding requirements for MEPPs and JSPPs that meet specified criteria (and of course the devil is in the details) seem to be a step in the right direction. What about proposals that would let industry groups or associations sponsor target benefit MEPPs for their members? Is that covered off under "investigate other forms of target date plans" that will be studied further?

A. Again, Harry's report did promote the idea of target benefit plans as did the Alberta/B.C. and Nova Scotia reports and I've heard a lot of comments subsequent to those reports suggesting this would be a very good thing. When I read this business about investigating other forms, I understood there may be some concern about income tax rules. Now I haven't personally spoken to people at CRA, although one of my colleagues has and we're not sure exactly where the problem lies in dealing with target benefit plans in terms of compliance with current provisions of the Income Tax Act (ITA).

But let's just say that if there is a problem with the ITA currently as applied to plans where the accrued benefit promise could be reduced on an ongoing basis, then we

must hope that the CRA will be looking already at its rules to see what kind of ITA changes could be made to accommodate these plans. If indeed that predicament exists, let us quickly advocate to CRA to make the necessary ITA changes so the all provinces who are interested in this can move ahead.

I suspect that Ontario is trying to sort out the legality of those plans and clearly hope that it will push CRA to move in that direction. Once we do get some sort of resolution or a confirmation from CRA that target benefit plans meeting certain criteria are accommodated by the current ITA, then I would sincerely hope that Ontario would move fast to push out more details on these target benefit plans so we can comment on them.

Q. Well it would seem that in view of the Duncan/Flaherty report and the provisions coming out of the PEI summit that there is some interest in this area.

A. Yes, and certainly the idea of having unrelated employers be able to participate in such a plan has some appeal. We just need to find every way we can to allow a plan which resembles and is structured around a defined benefit but isn't an absolute guarantee. This type of plan design I believe would apply to a number of private sector employers.

Whether single employers do so or they are willing to band together with a Board of Trustees or Board of Governors who can manage the MEPP on their behalf – either route would provide opportunities for employers to keep their DB plans. When you look at discussions at the PEI meeting and all the conversations that are going on federally, it is all about coverage. I think many of us are concerned that the direction we are moving in is to cut back the number of Canadians covered by pension plans -- not just the number, but the quality of those pensions.

To the extent the legislation is much more favourable to protecting the accrued benefit promise than to encouraging provision of future defined benefits, it does push private employers to convert DB plans to DC. The trouble there is that the typical DC plan in today's low interest environment is much more likely to provide a lower pension than today's typical DB plan. And that therefore means that over a longer period of time the quality of coverage will be going down. All that does is push us more and more in the direction of having to come up with different solutions because we didn't take look after private sector pensions.

Q. The big issue that the business press seems to have fixated on is future funding and benefit levels for the PBGF. Employers will have to pay premiums up to five times higher per member and yet maximum benefit levels will not increase above \$1,000/month. Nobody is happy. What do you think?

A. I think it is essential if you are going to have some kind of guarantee fund, for the benefits to be affordable. There are all sorts of ways that one may go about reforming the PBGF. Yet I can quite understand why employers who are running businesses very carefully and managing risk not only within the pension plan but also within their business would be pretty upset to find they are subsidizing the actions others may take with their pension plans.

Another possible idea, and I think the opportunities are still there, would be to have some kind of limits on the amount of a claim an organization can make so that it does protect the amount of assets in there for other organizations.

Yes, that might be very upsetting for employees of very large companies. But again, if the PBGF is meant to be there without going and using loads of taxpayer money, you've got to have mechanisms that protect the PBGF for employers, large or small.

Q. It's been two years since the Expert Commission Report was filed and there will be further consultations before this week's proposals come into law. What does this mean for DB pensions? Who are the winners and losers here? Will we achieve the fine balance the Expert Commission was aiming for that will strengthen the pension system and make the rules more equitable?

A. A big question.

First of all I think it is wise to bring these solutions out at a measured pace as they are doing. I know there has been a desire to move relatively quickly since the Expert Commission Report was released. However, since Harry began writing his report the world has changed in a very dramatic way so it is wise for Ontario to go a little slow in working out "its own fine balance."

I do hope that they will now move ahead relatively quickly and that we will see the next round of proposals in the form of draft regulations coming out in the fall which may be the case, according to rumours.

Who are the winners and losers? First of all, I think everybody wins by having a slower pace given the market changes that have taken place. They allow for more groups to be able to weigh in with their concerns and advice on the proposals. The question of a fine balance is a very broad term.

The way I see this is the balance may have shifted a little bit towards employers – for example, not having smoothing abolished and requiring mark to market. Another example occurs with indexed plans (mostly public service) where solvency liabilities do not have to include indexing. I think these are all ways of keeping those pension plans going.

Again, I think that we have some reasonable balance here.

There are always going to be parties who will be upset. I think the jointly-sponsored plans – the big public sector plans in Ontario – will be pretty happy they won't have to do solvency funding.

Single employer plans really wanted to avoid trapped capital. The ability to use letters of credit is helpful.

The government could go a little bit further and permit pension security trusts. I do hope the Ontario government will remain open to this concept, although provisions will not be included in the next round of regulations.

Thanks very much for joining me today Ian.

Thank-you, Sheryl. It's been a pleasure.

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