5 Labour and Workforce Development: Pension Regulation

Summary

Pension savings are a major component of the overall assets of many Nova Scotia families. These assets are saved throughout an individual's working life with the goal of providing economic security in their retirement years. Due to the importance of these savings the Province of Nova Scotia has enacted the Pension Benefits Act; the primary purpose of which is to help protect pensioners' entitlements to benefits promised under pension plans. The Pension Regulation Division of the Department of Labour and Workforce Development is responsible for administering and enforcing the Pension Benefits Act and Regulations. We completed a performance audit at the Division focusing on whether the Division's processes and procedures were adequate to ensure compliance with significant aspects of the Act related to the safeguarding of pensioners' benefits.

To effectively safeguard pensioner entitlements to pension benefits, the Division must have adequate processes and procedures in place to ensure that pension plan investment strategies are prudent, implemented, and appropriately monitored. In addition the Division must ensure that required pension contributions are made and, in the case of defined benefit plans, that plan assets will be sufficient to provide promised benefits.

The Division's processes and procedures designed to safeguard pension benefits are not adequate and require improvements. The Pension Regulation Division does not review pension plan investment policies to ensure prudence or verify that pension plan assets are invested in accordance with policy and legislation. The Division does not independently verify that pension plan administrators have formally documented investment policies and procedures or whether these policies have been reviewed annually as required.

Pension plan administrators are required to submit annual information returns. These returns are certified by the plan administrator and include important information such as the market value of plan assets and annual employee and employer contributions. However, the returns are not always supported by independent documentation and the information is not routinely verified by the Pension Regulation Division.

Triennial actuarial valuation reports for defined benefit plans are an important control to assess whether plan assets are sufficient to meet promised benefits. We noted these reports are not always submitted on time and that there is no penalty for late filing.

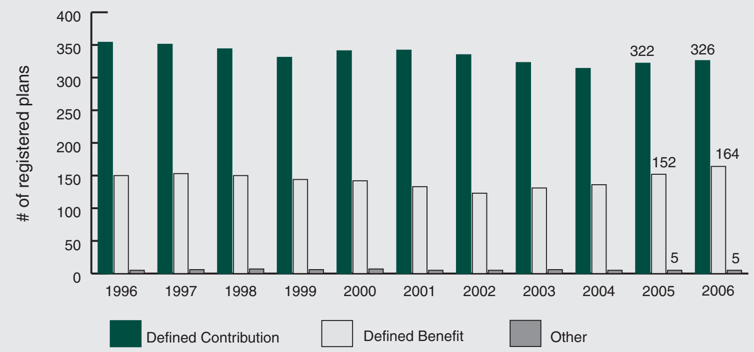
5 Labour and Workforce Development: Pension Regulation

Background

5.1 The Pension Regulation Division of the Department of Labour and Workforce Development is responsible for administering and enforcing the Pension Benefits Act and Regulations. A Superintendent of Pensions is appointed to perform the duties and powers pursuant to the Act. The Superintendent acts in accordance with directions from the Minister and prepares an annual report for the Minister. The annual report notes the main objective of the Pension Benefits Act is to safeguard employee entitlements to benefits promised under pension plans.

5.2 The Pension Benefits Act applies to private sector, not-for-profit and municipal government pension plans registered in Nova Scotia. The Act does not apply to employees who are subject to federal jurisdiction, nor does it apply to pension plans established for provincial public servants, teachers, judges, members of the legislature, or the Sydney Steel Corporation. The Pension Division's most recent annual report dated March 31, 2007 indicated that as of January 1, 2006, there were 411,518 paid workers in Nova Scotia, of whom 169,134 were members of pension plans. The Division is responsible to supervise 495 plans with a total membership of 102,490.

Exhibit 5.1
Plans Registered in Nova Scotia - January 1, 2006



Source: March 31, 2007 Annual Report of the Superintendent of Pensions

5.3 In Nova Scotia an employer may create a pension plan for its employees as a way to set aside funds to provide retirement income. The employer appoints a pension plan administrator who registers the pension plan with the Superintendent of Pensions. The pension plan administrator can be the employer, a pension committee, or an insurance company. The administrator receives contributions from the employer and employee to invest and create a pool of funds to provide retirement benefits to employees. The administrator also provides plan members with any required information and documents (e.g., annual employee statements).

5.4 There are two main types of pension plans – a defined contribution or money purchase plan and a defined benefit plan. The most common type of pension plan in Nova Scotia is a defined contribution or money purchase plan. However, historically the majority of Nova Scotia employees are members of defined benefit pension plans due to the high number of workers employed in the public sector (2006 - 55.6%).

5.5 The amount of pension benefit for each member of a defined contribution pension plan can only be determined near the employee's retirement as the pension is purchased from the accumulated contributions and investment earnings at that time. It is not possible to accurately determine if each employee's savings will be adequate to fund his or her retirement until the retirement date is reasonably imminent.

5.6 A defined benefit plan contains a specific formula to estimate the pension each member will receive upon their retirement. The employer must fund the pension plan to provide this level of defined benefits. Every third year an actuary estimates how large the defined benefit pension fund should be as well as required contributions to ensure pension benefits are adequately funded. By legislation, an unfunded liability when a plan is established or amended can be funded over 15 years. Subsequent solvency deficiencies which arise later, must be funded over five years. Two exceptions are municipalities and universities - municipalities are only required to fund a pension liability to an 85% solvency level until August 30, 2016, and universities may fund a solvency deficiency, which arose before January 1, 2006, within 15 years.

5.7 The Division's annual report states the safeguarding of employee entitlements to pension plan benefits is accomplished through establishing minimum funding standards and minimum benefit standards. The Division performs a number of functions including registering plans and amendments, reviewing plan administrator annual filings, investigating plan member complaints, and providing information and support to pensioners.

5.8 The Pension Regulation Division of the Department of Labour and Workforce Development has four employees - the Superintendent, two

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pension analysts and a secretary. The 2007-08 approved budget for the Division included revenues from fees and other charges of $400,000 and expenses of $323,000.

Audit Objectives and Scope

5.9 In February 2008 we completed a performance audit at the Pension Regulation Division of the Department of Labour and Workforce Development. The audit was conducted in accordance with Section 8 of the Auditor General Act and assurance standards established by the Canadian Institute of Chartered Accountants, and accordingly included all procedures we considered necessary in the circumstances.

5.10 The objectives of this assignment were to review and assess whether the Division's systems and processes are adequate to ensure compliance with the Pension Benefits Act and Regulations as well as the adequacy of performance reporting.

5.11 Generally accepted criteria consistent with the objectives of the audit do not exist. Audit criteria were developed specifically for the engagement and have been discussed with, and accepted as appropriate by, senior management of the Division.

5.12 Our audit work included interviews with Division management and staff; a review of legislation, manuals, public reports, and other documentation deemed relevant; as well as file testing.

Significant Audit Observations

Compliance with Legislation

5.13 *Conclusions and summary of observations* – We assessed whether the Pension Regulation Division's systems and processes were adequate to ensure compliance with the Pension Benefits Act and Regulations. We concluded that the current systems and processes were not adequate to effectively safeguard pensioners' benefit entitlements. We noted the Division does not independently verify whether pension plan investment policies are prudent, approved policies have been implemented, and whether they are being properly monitored and comply with the Act. In addition, there is no verification of whether the market value of plan assets being reported annually by the administrators is accurate and whether required contributions have been made. Relying primarily on information reported by plan administrators is not sufficient. The Division must ensure the information they use to assess the health of pension plans is accurate and plan assets are being managed in a manner which is prudent and proper.

5.14 *Annual information return* – Pension plan administrators are required to file an annual information return. The return includes important financial and other data related to the pension plan including the number of plan members, actual contributions remitted by members and employers, plan earnings for the year, and the market value of plan assets.

5.15 Plan administrators must also certify:

- the plan was administered in compliance with applicable legislation;
- required contributions were made;
- a statement of investment policies and procedures was developed which complies with the Pension Benefits Act;
- plan assets were invested in accordance with the investment policy; and
- the policy was reviewed by the administrator during the year.

5.16 We noted the annual information returns were completed as required for all 23 plan files tested.

5.17 *Pension plan monitoring* – The Division relies primarily on the information contained in the annual information return to fulfill its objective *"to safeguard employee entitlements to benefits promised under pension plans."* 22 of 23 pension plan files we tested had annual information returns which had been completed by plan administrators who were either management or staff of the pension plan employer.

5.18 When the Division receives the annual information return, the information is entered into a computer system. The Division conducts reasonableness checks on the number of members, contribution amounts (2006 - $458,436,230 as reported by Division) and market value of plan assets by comparing current year data with data from the prior year's return. Discrepancies are followed up with the plan administrator.

5.19 Based on the 23 annual information returns tested we determined that the Division had a documented process to review annual information returns, procedures were followed, and any issues or discrepancies noted were followed up and resolved. However, these review procedures were not sufficient as the information on the return was not verified to third party documentation.

5.20 The Division does not require independent verification of the number of plan members, the yearly contributions or the market value of assets reported by the plan administrator. Although the Act does not require the Superintendent to verify information in the annual return, Section 98 does empower the Superintendent to be able to receive any information related to the plan. The Division receives triennial actuarial valuation reports prepared by independent actuaries for all defined benefit plans. These reports verify the sufficiency of plan assets and annual contributions required to fund pension obligations. There was no similar check for defined contribution plans. We believe this is not sufficient.

5.21 Section 98 of the Pension Benefits Act allows the Superintendent to inspect or audit any books, records, or other documents related to a pension plan. Under the Act, the Superintendent may require a plan administrator to furnish any information deemed necessary to ensure compliance with provisions of the Act and Regulations. Certain other provinces conduct field visits of plan administrators on a test basis to confirm and validate information. Alternatively, the Superintendent could require plan administrators provide documentation to validate key pension plan information such as the market value of pension investments. If the pension plan annual information return is incorrect, the Superintendent's ability to provide an oversight role is compromised, and pensioners' benefits could be at risk.

Recommendation 5.1
The Pension Regulation Division should periodically validate information on annual information returns to supporting, external documentation.

5.22 *Compliance with pension plan investment policies* – Section 29 of the Pension Benefits Act notes *"The administrator of a pension plan shall exercise the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person."* Pension plans are required to establish a written statement of investment policies and procedures which comply with the Act. Schedule III of the Regulations outlines the nature of and certain restriction on eligible investments. Administrators are required to follow the Regulations in managing the pension plan.

5.23 The administrator of each pension plan must review the statement of investment policies and procedures annually. This review should include an assessment of whether the investment strategy remains prudent given the economic climate at the time. As a result of the review, the administrator should confirm or amend policies and procedures. Amendments to investment policies and procedures must be submitted to the Division and to the pension committee or actuary of the plan.

5.24 The Division does not review whether investment policies are prudent for the plans under its supervision. It generally does not have individual plan investment policies on file. Additionally, the Division does not verify that fund assets are invested in accordance with the plan investment policy, or whether the annual review by the administrator was completed as required.

5.25 The Division reviews defined benefit actuarial valuation reports every three years. These reports may indicate the pension plan fund rates of return are not sufficient to provide the planned pension benefits. In those cases we understand the Superintendent will ask the employer to review the investment strategy and the statement of investment policy and plan goals, and make changes if required. Actuarial valuations do not address whether plan assets are invested in accordance with investment policies, or whether the investments meet the requirements and restrictions of the Pension Benefits Regulations. Since there are no actuarial valuation reports for defined contribution plans, this periodic control over the prudence of investment does not exist for defined contribution plans.

5.26 An investment strategy which is not reasonable based on the current economic climate or which has not been implemented as designed poses a significant risk to plan assets, and ultimately to the benefits pensioners may receive in the future. The Division must have controls in place to help ensure pension plan investment policies are prudent and implemented as required to effectively regulate the Pension Benefits Act and safeguard pensioners' entitlements.

Recommendation 5.2
The Pension Regulation Division should implement a process to periodically verify that pension plan assets are prudently invested. The Division should also verify assets are invested in accordance with legislation and the plan statement of investment policies and procedures.

5.27 *Late filing penalties* – Section 13 of the Regulations requires that defined benefit plan administrators file a triennial actuarial valuation report within one year of the plan's year-end. The actuarial valuation provides the Division with an independent assessment of whether the pension plan has sufficient assets to meet future obligations to pensioners.

5.28 We tested eight defined benefit plans, which required triennial actuarial valuation reports. Three of the eight (38%) were filed late. We extended our test to include actuarial valuation reports filed over a three year period and noted that 25 of 200 (13%) returns were filed between 1 and 26 months late.

5.29 The Pension Benefits Act allows the Superintendent to charge late filing penalties related to annual information returns, but does not allow similar penalties for actuarial valuation reports. We understand that at least one other province imposes penalties for late filing. The triennial actuarial valuation report is an important reporting requirement related to defined benefit plans. The Division needs to ensure it receives these reports in a timely manner so that plans with unfunded liabilities can be identified and appropriate follow-up action taken.

Recommendation 5.3
Pension Benefit Act regulations should be amended to provide penalties for late actuarial valuation reports.

Accountability and Performance Reporting

5.30 *Conclusions and summary of observations* – We assessed whether the Pension Regulation Division complies with the requirements of the Pension Benefits Act and Regulations for accountability reporting and assessed the adequacy of reported performance information. We concluded the Division's annual reporting was not timely and did not contain adequate performance information. The March 31, 2007 Report of the Superintendent of Pensions was sent to the Minister on March 6, 2008. This report included a single performance measure for defined benefit plans and no measure for defined contribution plans. Accountability and performance reporting must be timely and include appropriate measures of performance to allow assessment of the Division's operational effectiveness.

5.31 *Timeliness of reporting* – Section 94 of the Pension Benefits Act requires the Superintendent report to the Minister of Labour and Workforce Development annually. The Minister is required to submit the annual report to the Governor-in-Council and present the report to the House of Assembly. As the annual report is a legislative requirement we reviewed its contents and tested the accuracy of the report's representations. We did not find any significant errors in the report.

5.32 Contemporary public performance reporting principles in Canada note that accountability reports must be seen as credible and have useful information provided on a timely basis. At the time of our audit, the most recent annual report tabled in the House of Assembly was for the March 31, 2006 year-end. The Superintendent's March 31, 2007 annual report was sent to the Minister for approval on March 6, 2008 but had not been tabled when this Report was written in Fall 2008.

5.33 The Superintendent's report for the year ended March 31, 2007 notes the information in the appendix was obtained from Statistics Canada's pension plans database information dated January 1, 2006. Certain information in the report was over two years old when it was presented to the Minister. We questioned the usefulness of such dated information and noted it was inconsistent with contemporary public performance reporting principles in Canada.

Recommendation 5.4
The Superintendent's annual report should be released to the public within six months of fiscal year-end.

5.34 *Performance measures* – The March 31, 2007 report includes a section titled Security of Retirement Income. This information was also used in the Department's Business Plan and Annual Accountability Report performance measures.

5.35 The outcome the Division wishes to achieve is security of retirement income for members of private pension plans. The Division will measure its progress towards this outcome by considering the percentage of plan members covered by defined benefit pension plans registered with the province that are (a) 100% funded; or (b) have a strategy in place to achieve full funding within five years. This addresses defined benefit pension plans only but a significant number of Nova Scotians are members of defined contribution plans. On January 1, 2006 there were 56,176 members of defined benefit plans and 45,335 members of defined contribution plans. There is no performance measure for the 45,335 members of defined contribution plans.

Recommendation 5.5
Performance measures should be developed related to the Division's supervision of defined contribution plans.

Response: Department of Labour and Workforce Development

General Comments

The Department of Labour and Workforce Development would like to acknowledge the work of the Auditor General in the review of the operation of the Pension Regulation Division.

RESPONSE: LABOUR AND WORKFORCE DEVELOPMENT

Response to Principal Findings and Recommendations

Recommendation 5.1:
The Pension Regulation Division should periodically validate information on annual information returns to supporting, external documentation.

The Department will recommend that the Government amend the Pension Benefits Regulations to require filing of audited financial statements in accordance with the proposal in the Regulatory Principles for a Model Pension Law developed by the Canadian Association of Pension Supervisory Authorities (CAPSA). If adopted, this would mean that audited financial statements must be filed for multi-employer pension plans, and for plans with non-pooled funds of more than $5,000,000.

Recommendation 5.2:
The Pension Regulation Division should implement a process to periodically verify that pension plan assets are prudently invested. The Division should also verify assets are invested in accordance with legislation and the plan statement of investment policies and procedures.

The recommendations of the Auditor General with respect to monitoring investments for prudence, and for compliance with legislation and the statement of investment policies and procedures, are not performed by any regulatory authority in Canada.

The Division is not able to adopt these recommendations. The Pension Benefits Act (the Act) imposes responsibility on the plan administrator to ensure the investments of the pension plan are invested prudently and in accordance with the statement of investment policies and procedures developed by the administrator. The Act does not specifically impose a role for the Superintendent in determining the prudence of investments. That responsibility rests solely with the administrator.

CAPSA has carried out an extensive review of the principles for regulation in the model pension law, and no recommendations have been made which would bring into effect actions similar to those recommended by the Auditor General.

For these reasons, the Department is not prepared to undertake the recommendations of the Auditor General.

Recommendation 5.3:
Pension Benefit Act regulations should be amended to provide penalties for late actuarial valuation reports.

The Department will recommend that the Government amend the Pension Benefits Regulations to provide a penalty for late filing of actuarial valuation reports.

RESPONSE: LABOUR AND WORKFORCE DEVELOPMENT

Paragraph 31 *"The Superintendent's report for the year ended March 31, 2007 notes the information in the Appendix was obtained from Statistics Canada's pension plan database dated January 1, 2006. Certain information in the report was over two years old when it was presented to the Minister, making the information's usefulness questionable and inconsistent with contemporary public performance reporting principles in Canada".*

The only complete source of information available on the participation of Nova Scotians in pension plans is Statistics Canada, as the Department's information relates solely to plans registered in the province. Roughly 90,800 Nova Scotians participate in pension plans registered elsewhere or that are not registered. Excluding this information would not give the Minister a correct representation of the number of Nova Scotians participating in pension plans. The information used in the report is the most current information available, and thus should be consistent with contemporary public performance reporting principles.

Recommendation 5.4:
The Superintendent's annual report should be released to the public within six months of the fiscal year-end.

The Superintendent will file the annual report with the Minister within six months of the fiscal year end.

Recommendation 5.5:
Performance measures should be developed related to the Division's supervision of defined contribution plans.

The Division will develop a performance measure in respect of the supervision of defined contribution pension plans.