

Canadian Federation of Pensioners

Comments Regarding the
Financial Sector Division, Federal Department of Finance
January 2009 Consultation Paper,

*Strengthening the Legislative and Regulatory Framework
For Private Pension Plans Subject to
The Pension Benefits Standards Act, 1985*

March 10, 2009

INTRODUCTION	2
COMMENTS: ISSUES FOR DISCUSSION	2
<i>Temporary Funding Relief (p.6)</i>	<i>2</i>
3A. <i>Solvency Measurement and Funding Rules (p.7)</i>	<i>3</i>
3B. <i>Requiring Full Funding on Voluntary Plan Termination (p.9)</i>	<i>4</i>
3C. <i>Partial Termination and Immediate vesting (p.10)</i>	<i>5</i>
3D. <i>Disclosure of Information (p.11).....</i>	<i>5</i>
3E. <i>Contribution Holidays (p.13).....</i>	<i>5</i>
3F. <i>Void Amendments (p.14).....</i>	<i>6</i>
4D. <i>Use of Surplus in Defined Contribution Plan Components (p.17).....</i>	<i>6</i>
5E. <i>Investment Rules (p.21)</i>	<i>6</i>
ADDITIONAL ISSUES	7
A. <i>Sponsor Bankruptcy and Insolvency.....</i>	<i>7</i>
B. <i>Commutated Values & Members Leaving a Plan.....</i>	<i>7</i>
C. <i>An Alternative to a Plan Wind-up</i>	<i>7</i>
D. <i>Need for a Pension Champion & Ongoing Stakeholder Consultations</i>	<i>8</i>

Introduction

The Canadian Federation of Pensioners (CFP) was formed in December 2005 as an umbrella organization to be a collective voice for formally organized retirees groups. Current active group members and other groups we communicate with represent over 100,000 single employer defined benefit pension plan (DB plan) retirees.

CFP did not have an opportunity to respond to the Finance Canada consultation paper on pension plans issued in May 2005 but some CFP member organizations made formal submissions and have subsequently met with Finance Canada officials for further discussions. CFP supports the valuable contributions that these groups have made towards improving the long term financial security of pensions for all DB plan retirees.

CFP has actively participated in the more recent provincial reviews of pension legislation undertaken by the Ontario Expert Commission on Pensions, the Alberta and British Columbia Joint Expert Panel on Pension Standards, and the Nova Scotia Pension Review Panel. We appreciate the opportunity afforded by Finance Canada to respond to its January 2009 consultation paper and look forward to continuing to participate in all future federal discussions and consultations that will lead to new and improved federal pension plan legislation and regulation.

An important overall observation that applies across all jurisdictions is that since 2005 there has been a significant change brought about by CFP and member groups who have advocated on the need for DB plan retirees to be recognized as key pension plan stakeholders. It is very gratifying to witness the wide acceptance for this and the opportunities that this has provided for retirees to be not only heard but be listened to. Retired plan members outnumber the active members in many DB plans. Their issues and concerns are not all the same as those for members. Unlike many plans, whose members have the support of labour unions in dealing with pension issues, retirees are most often left to fend for themselves. It is important that the current stakeholder recognition being given to retired members during consultations be also incorporated into revised legislation and regulations.

Comments: Issues for Discussion

Temporary Funding Relief (p.6)

The temporary funding relief regulations introduced in 2006 were viewed by many retirees as being over the top in terms of being made available to every DB plan sponsor. The events that lead to large solvency funding deficits at the end of 2006 didn't happen overnight. As far back as 2002, it was evident that the solvency surplus position held by a majority of plans was starting to slip away. Many sponsors chose to continue to take contribution holidays during the early 2000's at the expense of not building up a funding surplus in order to have a funding cushion.

In contrast, what happened to DB plan asset values in 2008 could best be described as an unforeseen catastrophe. And there is no certainty that asset values will recover as quickly

as they did beginning in 2006. It regrettably seems that the need for temporary solvency funding relief being proposed for implementation in 2009 is more universally required. What makes it regrettable is the increased risk it places on plan members and retired members, particularly when many plan sponsors are themselves very severely expose to the national and global financial and economic crises.

CFP therefore somewhat reluctantly supports the need for temporary regulations and believes the 2006 temporary regulation serve as an appropriate model. The Ontario Ministry of Finance is also looking to that model for possible use in that province. In discussions with senior Ontario ministry officials, CFP confirmed its support for requiring the approval of both members and retired members when sponsors wished to extend the solvency amortization period from five to ten years. In doing so it is understood that both groups have to agree, using the negative voting principle, and if either 30% of members or 30% of retired members voted negatively, the sponsor could not proceed. *Without this step, members and retired members (and OSFI) would be left questioning the need for why a sponsor needs to put plan members and retired members at increased financial risk.*

Implementation of the proposals in 3A below to raise the bar for continuous solvency funding levels would provide sponsors with improved capabilities for keeping DB plans solvent under all normal business, financial and economic cycles without the need to have extend solvency deficit amortization periods to ten years on a permanent bases as some are proposing.

3A. Solvency Measurement and Funding Rules (p.7)

CFP wholeheartedly agrees that this is a crucial area of pension plan legislation in need of a re-think. The following issues and considerations are in addition to the items discussed in this section of the consultation paper and should be included in any study or review of funding rules and measurements.

- 1) It is **solvency funding deficiencies** that create many of the current issues with DB plans and create problems for regulators and other stakeholders. Current legislation sets too low a standard by allowing solvency funding deficiencies to develop and by providing sponsors with up to five years to amortize them. As well, it sends the wrong message to sponsors by signalling that solvency deficits are a normal or acceptable business practice. The bar for funding requirements needs to be set higher. Every pension plan stakeholder would benefit in the long run if there was a requirement in legislation calling for **DB plans be kept fully solvent at all times.**

As long as a DB plan remains fully solvent key issues such as: an employer's business being placed under the Company Creditors Arrangement Act or the Bankruptcy and Insolvency Act; or when a business is re-organized, split-up, merged or sold; will have little or no impact on the vested rights of the plan members and

former members. Similarly, issues surrounding plan amendments will be much easier to deal with when the plan is fully solvent.

Support continuous full solvency by establishing a reserve fund. A Globe and Mail article posted on February 15, 2009 mentions that one reason why Spanish banks are in relatively strong financial positions during the current world crises is that their regulator forced them to save for rainy days by being pushed into “dynamic provisioning” in which they had to make higher-than-usual provisions during good times to protect them in bad times.

In order to sustain a higher level of solvency funding, CFP and other stakeholders have been advocating for what could be called a reserve fund, or rainy-day fund or “dynamic provisioning” for DB plans. That is each plan would have what the Alberta-British Columbia pension review panel refers to in its recommendations as a “pension security fund”. [Ref: Alberta-British Columbia pension review panel final report, issued November 2008, Recommendation 8.1.2-A].

It replaces the current ‘surplus’ funding concept and provides even more security by smoothing funding requirements and buffering against reductions in rates of return and during periods of economic turmoil. It could also be a way to pre-fund plan amendments.

- 2) Solvency funding assumes that should there be a plan wind-up, the fund would be used to purchase annuities for members and retired members. In the case of medium sized and larger DB plans, it could be very difficult or impossible for the Canadian annuities market to absorb the resulting demand. As well, there is another annuity issue regarding how to handle a wind-up where the plan includes pension indexing. (See Para. C on page 7 below regarding the need to consider having an alternative to plan wind-ups.)
- 3) No private pension plan sponsor is totally immune from a business or financial failure. One jurisdiction in Canada did bend to pressure from some sponsors by allowing them to be exempted from the solvency deficit funding rules in place at the time. These sponsors argued that essentially their businesses were too large to fail and that they would always be able to fund the current obligations of their plans. All but one of these businesses has subsequently been forced to re-organize their affairs due to financial failure and the last one is heading in the same direction. All of them had DB plans with significant underfunding and were not making solvency deficit amortization payments.

3B. Requiring Full Funding on Voluntary Plan Termination (p.9)

A sponsor who wishes to terminate and wind-up a DB plan should be required to ensure that the plan is fully funded. But OSFI should have the authority, to sanction the voluntary wind-up of a DB plan that has a solvency deficiency if it is determined on balance and after full investigation by OSFI that this is in the best interests of members and retired members.

3C. Partial Termination and Immediate vesting (p.10)

Having to distribute surplus funds coincident with partial termination poses a risk for retired members and the members for whom partial termination does not apply. It is the view of CFP that the surplus should remain in the fund to provide a cushion in subsequent years should the fund fall into a deficit position.

3D. Disclosure of Information (p.11)

Retired DB plan members are increasingly becoming aware of the long term financial risks associated with their pension income. This raises fears which are only exacerbated when there is a lack of communications and current information on the status of their pension plan.

There are a lot of inconsistencies with how plan administrators provide information on the status of a DB plan to retired members. There is also an issue with information on the financial status of the DB plan being provided too late to be useful. There are increasing opportunities for plan administrators to provide the same information that is sent annually and triennially to OSFI, to members and retired members at the same time. This can be done economically using (secured if necessary) websites which are accessible by more and more retired members as time goes by. Hardcopies should be made available for those without internet access.

Retired members, as key plan stakeholders, should be entitled to have access to the full text of their pension plan and all associated administration and governance policies. All of this can be posted on a website and would require little maintenance by plan administrators.

3E. Contribution Holidays (p.13)

The recent pension legislation reviews conducted in Ontario and jointly for Alberta and British Columbia are recommending tighter rules governing contribution holiday rules which CFP agrees are needed. CFP also supports recommendations from other stakeholders that sponsors should have a formal policy on contribution holidays. Retired members should be consulted on the drafting of such policy. Some retired members of contributory DB plans feel that contribution holidays provide current members with a free ride which they never received while they were working.

But in addition, it would be a good control policy to require that sponsors who wish to take a contribution holiday must first request approval from OSFI in order to protect the vested interests of members and retired members. The concern is that in tough financial and/or economic times, a sponsor can be under severe pressure to put a higher priority on funding the business versus funding a pension plan which can lead to pressures on compliance with rules and policies.

OSFI, which is there to protect the interests of members and retired members, is in the best position to question the application and to request more information such as an estimated solvency valuation if the current circumstances would warrant it.

3F. Void Amendments (p.14)

Retired members are left financially vulnerable whenever there is a solvency deficit. The proposal in the consultation paper to use a solvency ratio of 0.85 as the point below which plan amendments would not be allowed is too low.

CFP understands that there can be situations where plan amendments are desired but as long as the plan has a current solvency deficiency, the sponsor should be required to file suitable documentation with OSFI to demonstrate that it has the ability to make the necessary special payments to the pension plan and will adjust any solvency deficit amortization schedule accordingly and to request approval before proceeding with implementation.

4D. Use of Surplus in Defined Contribution Plan Components (p.17)

There is a requirement to place more restriction on sponsors accessing DB plan surplus for offsetting DC plan service costs contributions. Currently any surplus can be re-directed which potentially can leave an insufficient cushion in the DB plan fund for use should the fund incur a solvency deficit. There needs to be minimum threshold(s) reached before excess funding can be withdrawn or transferred within a hybrid or combination plan by the sponsor for any purpose. Setting these thresholds in regulations has to go hand-in-hand with the setting of new minimum solvency funding requirements (Ref: Consultation paper, Para. 3A).

5E. Investment Rules (p.21)

As retired members, we have little choice but to accept that whoever sets the rules is doing in such a way as to protect our best interests. We question how well our interests are currently being protected. We don't have the expertise to know if these rules should be reviewed more often than 15 year intervals. We don't know the criteria used to establish the rules 15 years ago. Was there consideration given to requirements which could or should vary according to the size of the plan's assets?

The recent pension plan legislation reviews conducted in Ontario and Alberta/British Columbia have both put forward the notion that their jurisdictions could set their own rules. More study and consideration is needed before CFP could sanction a go-it-alone approach. Is the pool of needed knowledge and expertise in Canada large enough and decentralized enough for the setting of rules on a more local basis? Will setting the rules locally make for better choices and for what purposes? What could be the impact on the financial security of pensions?

There needs to be full transparency and communication with all the stakeholders on this critical aspect of pension plan regulation.

Additional Issues

A. Sponsor Bankruptcy and Insolvency

Any discussion on DB plan issues has to include the financial exposure of members and retired members when the business of a plan sponsor fails and the provisions of the Bankruptcy and Insolvency Act (BIA) are applied. Recent BIA amendments do provide limited creditor protection for some types of payments owed to a pension plan. But DB plans themselves are not preferred creditors. This is somewhat ironic in that a business can fail because it cannot meet its obligations to amortize a DB plan solvency deficit.

The forced wind-up of a DB plan having a solvency deficit can be devastating for retired members. A great many retired members rely on their DB plan benefits as their major source of income and most of them are unable to replace lost income by rejoining the workforce. Given the current economic and financial crises, the risk for forced plan wind-ups has perhaps never been higher with no certainty as to when these crises will ease and there is no guarantees that these or similar crises won't happen again in another few years.

CFP realizes that adding DB plans to the list of preferred creditors could have major repercussions for the other preferred creditors and for plan sponsors. Under current legislation a DB plan can incur very significant solvency deficits which put a large financial burden on the plan sponsor. However, the risks for other preferred creditors could be virtually eliminated should there be an implementation of the proposals outlined in 3A (1) above, calling for continuous full solvency of DB plans and the use of a reserve fund to facilitate this level of funding. Preferred creditor protection for the DB plan would still be required should the solvency studies have under-estimated the funding requirements and wind-up costs.

B. Commuted Values & Members Leaving a Plan

In recent years there has been a trend towards giving members leaving a DB plan the choice of taking a lump sum withdrawal from the pension plan or to take a deferred pension. The commuted value of the lump sum is based assuming the plan is fully solvent. If the plan actually had a solvency deficit at the time, any lump sums being withdrawn will only increase that deficit. Any solvency deficit increases the financial risks for the remaining members and the retired members which is not acceptable.

Should there be a solvency deficit at the time the commuted value is calculated, this should be taken into consideration and pay out a reduced lump sum. There could be a further provision made to re-calculate the commuted value in five years* or less should the solvency deficit be totally amortized and provide the former member with a top-up payment. *Or in ten years or less for plans which qualify under the proposed temporary funding relief measures.

C. An Alternative to a Plan Wind-up

As previously mentioned, the wind-up of a medium or large pension plan could be very difficult if the annuity market can't handle it. And in times of low interest rates and

returns on investments, annuities can be more expensive than was assumed in calculating the plan's solvency level.

There needs to be alternative to winding-up a plan under certain conditions, for example, a plan with retired members but having no active members and the sponsor's business has been sold or liquidated. In this day and age of business re-organizations, spin-offs, mergers and so on, there is a growing risk of retired members and even some former members finding themselves in DB plans that have been orphaned.

There needs to a provision in legislation to provide for a place or a means by which qualifying plans can continue to be administered under government or agency control.

D. Need for a Pension Champion & Ongoing Stakeholder Consultations

The changes needed to update the current Pension Benefits Standards Act and related regulations are very substantive and will require a major effort to implement. In addition, CFP believes that there is an ongoing need to keep pension legislation more current than has been the practice in the past, particularly in order to provide the necessary support for new types or variations in private pension plans needed to better ensure more employers and employees can benefit from them.

CFP fully supports the recommendations in chapter ten of the Ontario Expert Commission on Pensions final report, *The Future of Defined Benefit Pensions and Pension Policy* [7]. The Commission has made many observations and proposals which bolster the need to 'champion' the implementation of new requirements and processes being considered as part of bringing current pension legislation up to date. In addition to establishing a pension champion office, the Commission recommends the establishment of 'Pension Community Advisory Council' that would go a long way towards facilitating communications regarding issues and ideas between and amongst government and pension plan stakeholder communities.

Consideration of the above should include determining the viability of establishing a government ombudsman position to assist plan retired members. Few retired members, either as individuals or as organized groups, have affordable access to legal or other professional advice on matters relating to their pension plan or their pensions. This assistance is needed over and above what is provided by OFSI. It might be possible to include the ombudsman's function in with those of the pension champion mentioned above.

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CFP Canadian Federation of Pensioners

Jim Murray, Chairman
CFP Pension Reform Committee
Tel. 416-283-4557
jas.murray@sympatico.ca
31 Rowallan Drive, Toronto, ON
M1E 2Y5

Alternate contact:
Jack Walsh, Chairman
CFP Executive Committee
Tel. 416-925-6047
jack.walsh@sympatico.ca
1307-110 Bloor St. West,
Toronto, ON, M5S 2W7

The Canadian Federation of Pensioners (CFP) was formed in December 2005 to bring together retiree groups for the purpose of exploring pension plan issues from a retirees' point of view. Currently CFP is focusing on the need to improve the long term security of single employer defined benefit pension plan (DB plan) pensions by:

- Participating in government and other forums that have been formally established to review issues and challenges with DB plans; and
- Identifying pensioner issues with the current Canadian legislation for when a business is sold or merged, declared insolvent, bankrupt or is forced to wind-up, and the pension plan is underfunded.

CFP is a growing organization which currently has eight actively involved pensioner groups whose DB plans are sponsored by a wide spectrum of businesses and whose individual members encompass retired corporate officers, senior executives, management, non-management, union and professional employees. In addition, CFP liaises with a number of other retiree groups which, together with the 8 active groups, represent the interests of over 100,000 DB plan pensioners.