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March 10, 2009

VIA E-MAIL

The Honourable Jim Flaherty, P.C., M.P.  
Minister of Finance  
140 O'Connor Street  
Ottawa, ON K1A 0G5

Dear Minister Flaherty:

As the Chief Executive Officer of NAV CANADA and the senior officer responsible for one of Canada's largest defined benefit pension plans, I am writing to urge you to take meaningful, permanent action to deal effectively with the crisis in solvency funding rules associated with defined benefit pension plans in this country.

Let me first express my strong endorsement of the attached joint submission made by the Chief Financial Officers of NAV CANADA and six other large federal defined benefit pension plan sponsors in response to the consultations launched on private pension plans. The joint submission provides the consensus views of the seven companies on many of the critical issues outlined in your department's consultation document. I hope that our companies' efforts to create this set of proposals will assist you in making the decisions necessary to address this crisis.

Secondly, I would like to reiterate our thanks to you and the government for the commitments made related to defined benefit plans in the Fall 2008 Economic Statement. It is my view that the need for government to have intervened in the Fall for the second time in three years to deal with the volatility in pension solvency deficits speaks loudly to the need for permanent measures to be implemented this year.

The changes in the world since solvency funding rules were introduced in 1987 have been profound. The rules for dealing with solvency deficits have not kept up to the changes in globalized markets, nor are they flexible enough to deal effectively with the extreme volatility of financial markets. The net result is that current rules are too burdensome for plan sponsors and are leading to the undermining of the competitive position of Canadian companies. I am in agreement with you and the government that meaningful permanent changes are needed. We cannot continue to deal with successive crises on a year-to-year basis. NAV CANADA, our employees and our retirees need greater certainty than that provided by temporary relief measures. Only a permanent solution can provide this.

Given the onerous nature of the current solvency funding rules for defined benefit plans, urgent, permanent action is needed. The current rules severely limit my company's ability to continue to invest in important capital projects and operating initiatives. Diversion of financial resources to fund solvency deficits will have adverse impacts not only for NAV CANADA and for the Canadian economy, given the role played by capital intensive businesses, but also for employees and retirees. The reality is that unless the solvency funding relief outlined in our seven companies' joint submission is provided this year, the ability to maintain defined benefit pension plans will be severely challenged in the future.

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The seven CFOs have carefully thought out the proposals for permanent changes. The overriding concern has been to respect the government's clearly-stated imperative that the pension legislative and regulatory framework be balanced, in effect reflecting the interests of both corporate sponsors and plan members. The proposals advocated in this letter and its attachment will ensure that certain minimum standards are met to enhance benefit security for plan members, while at the same time meeting the needs of companies to deal with the extreme volatility of markets. [My company's plans cover 5,300 employees and provide pensions for 2,300 retired employees and their beneficiaries.]

The specific proposals contained in the joint submission provided by our seven companies will help protect our ability to inject billions of dollars of capital into the economy over the next several years and enhance pension security for Canadian employees and retirees who have worked for companies that want to continue to contribute significantly to the health of the Canadian economy.

I would like to expand upon a few of the points that have been proposed by the seven companies in our joint submission and comment on other issues raised in the consultation paper.

### **Indexed Plans**

In the area regarding solvency measurement, a specific point is made regarding the funding of indexed pension benefits. Solvency funding volatility is particularly pronounced in an indexed plan. Yet it is vitally important for your government to be seen to encourage those private sector companies whose pension plans provide guaranteed indexing to continue to do so. This is especially true at the present time, given the impact of recent market conditions on people's retirement plans, rising levels of debt, lower levels of savings, devaluation of the housing market and longer life expectancy.

We believe that the best way to address the untenable situation faced by indexed pension plans is to permit the value of indexing to be excluded from the calculation of solvency liabilities and funding requirements. Instead, the indexed benefit would be provided for through the going concern funding mechanism. Under accepted actuarial practice, the value of indexing would still be included in the hypothetical "wind-up liabilities" and reported to readers of an actuarial report, but the sponsor should have the option of excluding the value of indexing from "solvency liabilities", and hence from the calculation of minimum solvency special payments. The advantage of excluding indexing is that it directly addresses the special circumstances of indexed pension plans and also encourages the continuation of automatic pension indexing before this feature disappears altogether from private sector pension plans. This proposal is consistent with the pension provisions in both the provinces of Ontario and Nova Scotia.

An alternative way to address this issue would be for your regulatory system to permit administrators of ongoing plans to amend their plan termination/wind-up provisions, in accordance with a negotiated agreement between the sponsor and the plan members or their representatives. For example, consider a plan like ours where the indexation increases are automatically in line with the CPI. Such an agreement could provide that, should the plan not be fully funded at future termination, CPI-indexing of the pension benefits accrued under the plan at plan termination would not be provided after the effective date of plan termination. Instead, these accrued pension benefits would be indexed at a fixed rate determined by the plan Actuary, up to the Income Tax limit, but only to the extent that surplus assets remain upon final settlement. The agreement would not reduce any member's or former member's accrued pension, pension in pay or commuted value. In fact, indexation adjustments in line with the CPI would continue for as long as the pension plan remains a going concern entity. The result of this plan amendment would be a reduction in the plan's solvency liabilities while leaving all benefits (including CPI-indexing) intact as long as the plan is ongoing.

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**Discount Rate**

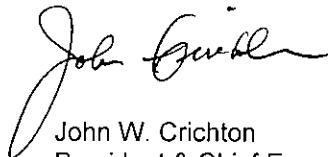
I also want to particularly emphasize the importance of the joint submission recommendation regarding the use of discount rates based on yields on long-term investment grade corporate bonds. This approach much more closely replicates what would actually happen in a pension plan wind-up situation. In the unlikely scenario of a pension plan wind-up, our plan would have to continue operating for a lengthy period of years to ensure that accrued pensions are fully paid, which means that the plan assets would continue to be invested in the markets. The joint submission recommendation would serve to eliminate the most arbitrary and artificial part of the current funding regime (the use of hypothetical annuity prices) when in fact annuities are not available in the marketplace for a plan of our size or for any CPI-indexed plan.

**Disclosure**

In addition to our endorsement of the establishment of a Statement of Funding Policy as detailed in the joint submission, NAV CANADA is also supportive of regulatory change to support the dissemination of required disclosure items by electronic means at the option of the plan member or beneficiary as well as the expansion of categories of members required to receive plan information to include deferred vested members and retirees. However, the requirement for a personalized annual pension statement detailing the benefits to which the deferred vested member or retiree is entitled should not be required, as this information is provided at time of termination in accordance with the Pension Benefits Standards Act.

I trust that the specific proposals made will meet with your approval and allow you to move forward with a balanced solution to the pension funding crisis which exists today. I would be very pleased to meet with you to discuss these proposals in more detail and look forward to doing so in the near future.

Sincerely,



John W. Crichton  
President & Chief Executive Officer  
NAV CANADA

JWC/rgb

Attachment: 1

c.c.: The Right Honourable Stephen Harper, Prime Minister  
The Honourable Tony Clement, Minister of Industry  
The Honourable John Baird, Minister of Transport, Infrastructure and Communities  
Diane Lafleur, Director, Financial Sector Policy Branch, Department of Finance



**Joint Submission to Department of Finance Canada on its  
January 2009 Pension Plan Consultation Paper**

Submitted by the Chief Financial Officers of Air Canada, Bell Canada,  
Canada Post, Canadian National Railway Company, Canadian Pacific  
Railway Limited, MTS Allstream and NAV CANADA

March 5<sup>th</sup>, 2009

## **INTRODUCTION**

This submission to the Department of Finance is being made by the Chief Financial Officers (CFOs) of seven major federally-regulated employers in the transportation and communication industries, being:

Air Canada	Michael Rousseau
Bell Canada	Siim Vanaselja
Canada Post	Wayne Cheeseman
Canadian National Railway Company	Claude Mongeau
Canadian Pacific Railway Limited	Kathryn McQuade
MTS Allstream	Wayne Demkey
NAV CANADA	Brian Aitken

Our seven companies have been sponsors of Defined Benefit (DB) pension plans for decades. Currently, our defined benefit pension plans, all of which are registered under the Pension Benefits Standards Act (PBSA), collectively cover approximately 162,000 employees and provide pensions to over 145,000 retired employees and their beneficiaries. Our pension funds collectively hold approximately \$56 billion of assets (December 31, 2008), which represents approximately 60% of the assets of all of the defined benefit plans registered under the PBSA. Throughout the years, our defined benefit plans have delivered pension benefits to hundreds of thousands of Canadians without ever missing a payment. Over the last five years alone, our pension plans have collectively paid out approximately \$15 billion to our pensioners and their beneficiaries and other plan members.

## **FOUNDATION AND PRINCIPLES OF OUR SUBMISSION**

We – the CFOs of our seven organizations – strongly believe that meaningful, permanent actions by the Federal Government are urgently required to address the onerous and volatile nature of the current solvency deficit funding rules for defined benefit pension plans. The current rules severely limit our companies' ability to invest capital to enhance our infrastructure and grow our businesses, thereby adversely impacting not only our companies but also the Canadian communities in which we operate and the Canadian economy in general. Further, the current rules hinder our ability to compete in North American and global markets.

We believe that this submission is consistent with the principles outlined in the Consultation Paper, namely that:

1. The rules governing private pensions should be reflective of the voluntary and contractual nature of the arrangement;
2. Employees and retirees should have the necessary information to make informed decisions; and
3. The legislative and regulatory framework should ensure that certain minimum standards are met in order to ensure a level of benefit security for plan members.

**Joint Submission to Department of Finance Canada  
On its January 2009 Pension Plan Consultation Paper**

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We acknowledge the critical importance of the security of the benefit payments for the members of DB plans, but strongly believe that the best security for plan members is a financially strong plan sponsor.

**This submission articulates our concerns and our proposals for changes to the current framework. Our proposals are presented as one cohesive package that is intended to be taken as a whole, and are consistent with the principles of balance, transparency and security that were outlined in the Consultation Paper.**

There are some elements of the Consultation Paper that we have not addressed as a group – each of our organizations may choose to address these elements in their individual submissions.

We consent to this submission being posted on the Department of Finance web site and to a copy of this submission being forwarded to OSFI.

**OUR OVER-RIDING CONCERN WITH THE CURRENT REGULATORY FRAMEWORK**

All stakeholders recognize that the world has changed significantly since solvency funding rules were introduced in 1987. The members of our pension plans have become older (and are living longer), while the business world and financial markets have become more global, and certainly more connected. Our customers, our employees, our shareholders and the communities in which we operate all require that we be more competitive. Current pension laws and regulations severely and negatively impact that competitiveness. These factors combined with extremely volatile financial markets (as demonstrated by their recent rapid collapse and for which there is presently no end in sight) have made the current solvency funding rules far too onerous on sponsors and have undermined their competitiveness and productivity.

DB pension plans such as ours have played a significant role in the Canadian retirement income system, but today their survival is severely threatened. Without meaningful, permanent changes to the current solvency funding rules, our ability to maintain our DB pension plans will be seriously challenged.

**The unnecessarily onerous and volatile solvency deficit funding rules are, without a doubt, creating an unwarranted crisis for companies that sponsor defined benefit pension plans.**

- Our seven companies' aggregate pension contributions over the last four years have been large and volatile:

2005	\$1.2 billion
2006	\$1.7 billion
2007	\$0.8 billion
2008	\$1.0 billion

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- Five-year funding of our seven companies' December 31, 2008 solvency deficits (with assets reflected at market value) would result in aggregate annual contributions of \$3.5 billion, an increase of \$2.5 billion over 2008
- Ten-year funding of these solvency deficits would result in aggregate annual contributions of \$2.4 billion, which would represent an increase of \$1.4 billion over 2008.

Despite the massive increase in contribution requirements for our collective pension plans, they remain reasonably well funded with the market value of our collective plans' assets equal to approximately 83% of their solvency liabilities as at December 31, 2008.

**URGENT CHANGES REQUIRED TO SOLVENCY FUNDING RULES**

It is critical that meaningful, permanent changes to the regulatory framework be made in 2009 to address the onerous and volatile nature of solvency deficit contributions required under the current rules.

**We are requesting that the solvency deficit amortization period be permanently increased from five years to 10 years for all current and future solvency deficiencies, without any conditions.**

It is imperative that this longer amortization period be provided without any conditions.

- Requiring member consent in an area as complex and sensitive as pension benefit security requires a complicated and difficult communication process that will be impractical for most plan sponsors to implement. As well, it is a process that will inevitably create tensions which are attributable to the current funding rules being excessively onerous.
- Letters of credit (used to provide security under the temporary solvency relief measures) are no longer an inexpensive, readily accessible means of securing pension benefits. Letters of credit can, however, serve as a pragmatic approach to addressing risk/reward asymmetry in DB pension plans, as discussed later in this submission.
- What is required is certainty, predictability and clarity – a permanent fix to get away from a continual cycle of temporary relief measures.

The existing Regulations under the PBSA permit the solvency deficit amortization period to be so extended, thereby permitting this change to be enacted promptly without waiting for the enactment of the Government's proposed PBSA amendments. We urge the Government to make this change during 2009, since companies require more certainty around future years' pension contributions as they proceed with the development and implementation of their corporate capital and operating plans.

## **IMPORTANT ELEMENTS CONCERNING SOLVENCY MEASUREMENT**

We are seeking changes to three elements of how solvency liabilities are determined:

1. Discount rate. Our companies have, over the last several years, expressed concerns with respect to the conservative nature of the discount rates used to calculate solvency liabilities for both active and retired members. We have been working with the Canadian Institute of Actuaries (CIA) to address these concerns. We are encouraged by recent developments, namely the CIA's new commuted value standard and the recognition by the CIA, with OSFI's concurrence, that large and/or indexed pension plans cannot immediately settle their obligations by purchasing annuities.

Given this recognition by the CIA and OSFI, it is important for the Government to take leadership in prescribing a discount rate for solvency liabilities that is better aligned with the marketplace. We recommend that the Government introduces a regulation to prescribe the discount rate based on a benchmark AA corporate bond index.

In the meantime, it is imperative that OSFI continue to exercise its judgment and discretion, based on the recently adopted CIA standards, especially for large and/or indexed plans such as ours.

2. Asset smoothing. We emphasize the importance of continuing to allow sponsors to retain asset smoothing methods for solvency funding purposes, to mitigate the contribution volatility resulting from the mark-to-market nature of the solvency funded status. We believe that the Government's Budget 2009 announcement that introduces a deemed trust requirement if a smoothed asset value exceeds 110% of the market value is an unnecessary complication, as asset smoothing methods are, by their very nature, self-correcting over short periods of time. We believe that OSFI should accept caps higher than 110% without a deemed trust applying.
3. Indexed plans. For pension plans that contain automatic inflation indexing provisions, the calculation of solvency liabilities is especially burdensome. We believe that the best way to address the untenable situation faced by sponsors of indexed plans is to exclude indexing from the calculation of solvency liabilities when determining solvency amortization payment requirements. Funding of the indexed benefits, including deficit amortization, would continue to be provided through the going-concern funding valuation (which more closely matches the period of funding to the long-term nature of this portion of the pension liability). This proposed change, which is consistent with provisions that have been in effect in Ontario and Nova Scotia for more than 15 years, would greatly facilitate the maintenance of automatic inflation indexing provisions in private sector plans.

## **PARTIAL PLAN TERMINATIONS**

We support the elimination of the concept of partial plan terminations from the PBSA. In exchange, we propose that pension benefits fully vest after one year of plan membership (as opposed to two years at present). One year vesting (as opposed to immediate vesting as proposed in the Consultation Paper) is a compromise that reflects the small benefit value that typically applies for members who terminate with less than one year of plan membership versus the administrative costs associated with processing vested benefits.

## **RECOGNIZING THE NEED FOR A BALANCED APPROACH TO STRENGTHEN THE LEGISLATIVE AND REGULATORY FRAMEWORK**

We recognize the need for a balanced approach for strengthening the legislative and regulatory framework. In return for meaningful, permanent solvency funding adjustments, our seven companies support the following changes in the regulatory framework:

1. A requirement for plan sponsors to fully fund any deficit on plan termination (with such funding either, at plan sponsor discretion, made in a lump sum or amortized over a period of up to five years). It is imperative that the outstanding obligation be treated as unsecured debt of the sponsor and not rank ahead of any of the sponsor's other unsecured debt.

We would support provisions that would allow a plan to be terminated in an underfunded position by virtue of an agreement between the sponsor and the plan members. With respect to member consent thresholds for such an agreement, we suggest that the Government adopt the member consent provisions contained in the 2006 temporary solvency funding relief regulation.

2. A requirement that plans must file actuarial valuation reports annually with OSFI, irrespective of the plan's funded status. Removing the ability for a plan sponsor to continue to take a contribution holiday for another year or two as if the plan still has a surplus, when in fact the markets may have dramatically deteriorated, will have a material beneficial impact on benefit security once the markets recover and surpluses return.
3. Greater disclosure to all plan members of the plan's funded status, the plan's investment policy and a statement of funding policy. The statement of funding policy should address the sponsor's policy with respect to contribution holidays, but should refrain from addressing those funding issues which are linked to the sponsor's management of the financial risks associated with the operation of its business and are typically reserved for decision by the sponsor's board of directors and therefore considered confidential.
4. A prohibition on plan improvements if a plan is less than 85% funded on a solvency basis (or if the improvement would result in the funded status dropping below this 85% threshold).

5. An increase in the current Canada Revenue Agency “excess surplus” limit on employer contributions above its current 10% surplus threshold to 25%, thereby giving employers the option to pre-fund cyclical market downturns.

### **ADDRESSING RISK/REWARD ASYMMETRY**

The Consultation Paper only indirectly seeks comments regarding risk/reward asymmetry (attributable to plan sponsors being solely responsible for any pension deficits while their access to surplus is restricted). Although surpluses may appear remote at the present time, the conservative nature of the solvency liability calculation, together with the required amortization of solvency deficits, ensures that trapped capital and risk/reward asymmetry issues will emerge at a future date. We encourage the Government to address these issues at the present time.

A practical approach to addressing trapped capital and risk/reward asymmetry is to permit plan sponsors to use letters of credit in lieu of solvency contributions, to the extent that these contributions exceed going-concern deficit contributions. The letters of credit must be permitted to be reduced or canceled if a solvency surplus later develops. We note that Alberta and British Columbia have adopted this approach on a permanent basis.

For letters of credit to be effectively utilized for this purpose, they must be an alternative source of funding that sponsors can voluntarily utilize. They cannot be a trade-off for lengthening solvency deficit amortization periods for the reasons outlined earlier in this submission.

We request that the Government permit sponsors to utilize letters of credit for this purpose.

We understand that other organizations may be proposing to Finance that solvency valuations include a provision for adverse deviations (PfAD), and that, as a minimum, no contribution holidays be permitted until the plan’s assets exceed the plan’s solvency liabilities by an amount equal to the PfAD. Our companies believe strongly that such a PfAD is not appropriate unless the PBSA were to be amended to provide plan sponsors with clear entitlement and access to surplus assets.

### **CONCLUSION**

We support the need for a balanced approach that will provide an acceptable degree of funding flexibility for sponsors and both transparency and pension benefit security for plan members.

With the continuing lack of liquidity in the capital markets and the continuing decline in equity markets in early 2009, and with the need for companies to plan now for their increased pension contributions over the next several years, it is critical that these issues be urgently addressed. The proposals that we have made in this paper would free up billions of dollars over the next several years to be productively invested within our businesses for the benefit of all of our stakeholders as well as the communities in which we operate.

We believe that our proposed solution provides an appropriate level of balance.

**Joint Submission to Department of Finance Canada  
On its January 2009 Pension Plan Consultation Paper**

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We look forward to the opportunity to continue our dialogue with the Department of Finance.

Respectfully submitted,



Michael Rousseau  
Executive Vice President and Chief Financial Officer, Air Canada



Siim Vanaselja  
Executive Vice-President & Chief Financial Officer, Bell Canada



Wayne Cheeseman  
Chief Financial Officer, Canada Post



Claude Mongeau  
Executive Vice-President and Chief Financial Officer, Canadian National Railway Company



Kathryn McQuade  
Executive Vice-President and Chief Financial Officer, Canadian Pacific Railway Limited



Wayne Demkey  
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Brian Aitken  
Vice President, Finance, Chief Financial Officer and Treasurer, NAV CANADA