

## **Response of the International Association of Machinists and Aerospace Workers to the Department of Finance Consultation Paper “Strengthening the Legislative and Regulatory Framework for Private Pension Plans subject to the Pension Benefits Standards Act 1985”**

The International Association of Machinists and Aerospace Workers represents over 45,000 Canadian workers, including over 15,000 in the federal jurisdiction, most of whom are members of pension plans subject to the PBSA. We appreciate the opportunity to provide our views on proposals to amend the PBSA and its regulations, and are eager to participate in the subsequent public consultations.

We hope that we will be given the opportunity to comment on draft changes to the Act and Regulations, when these are prepared.

With respect to the general principles for change, we would raise an issue with the second principle – information access for employees and retirees. The federal regulator (OSFI) seems to see its “clientele” as plan sponsors and employers, and is reluctant to provide information to plan members and unions about its actions and its interactions with plan sponsors. This stands in the way of Principle 2. OSFI must be open and honest with the plan members and their representatives in whose interest it is supposed to be working.

We believe that an additional principle should be added to the three proposed. Changes to the legislation and the related funding regime should, at the very least, not reduce overall benefit security. Preferably, they will actually increase benefit security. The ultimate package of changes should reflect this goal.

On the specific issues raised in the Consultation Paper

### *Pension Surplus Threshold*

The current 10% surplus limit in the Income Tax Act is too restrictive. In the current low-interest-rate environment, plans with solvency deficiencies may have a going-concern surplus that does not allow them to be prudently funded. The ITA limit should be increased substantially – to 25% at a minimum. There is little likelihood of plan sponsors using these provisions as a tax avoidance device, in light of their general reluctance to fund even at the current minimum requirements.

### *Temporary Funding Relief*

We agree that the requirement for temporary relief on solvency funding should depend on member and retiree approval. Sponsors should not be allowed to reduce their contributions and the security of earned benefits without convincing those most affected of the financial necessity of such changes.

In any case, the amount of reduced contributions as the result of solvency funding relief should be given preferred creditor status in the event of employer bankruptcy.

There should also be stricter conditions concerning relief and corporate re-organizations. After receiving funding relief through a special regulation in 2004, Air Canada management systematically dismantled the corporation and disbursed most of the resulting cash to investors and themselves, leaving pensions and pensioners extremely vulnerable in the current downturn. They should have been required to make full pension contributions before sucking the cash out.

With respect to letters of credit, we doubt that firms that are most in need of relief would be able to get such letters, particularly in the light of current tight credit conditions. In addition, we have a concern about the capacity of the federal regulator to monitor such letters of credit to ensure that they offer effective and continuing protection.

### *Defined Benefit Plan Issues*

#### *Solvency Measurement and Funding Rules*

With respect to more permanent solvency funding rules, a number of proposals have come forward from various sources. The recent report of the Ontario Expert Commission has recommended that the term for solvency funding should vary with the funded situation of the plan. Plans close to fully (over 95%) funded would have a shorter amortization period than plans below the threshold. This might be acceptable, if it were tied (as in the Ontario proposal) to restrictions on contribution holidays for plans with only small margins of surplus.

We see no effective way of trying to link solvency funding to the “financial strength of the sponsor”. As recent events have show, size is not evidence of financial strength, and corporations can shift from apparently strength to virtual bankruptcy in a short period of time. Certainly, the pension regulator would not have the resources to assess, on an ongoing “real-time” basis, the financial strength of plan sponsors.

With respect to letters of credit, similar problems arise. Who will ensure the continuing validity and value of the terms of the letter and the reliability of the issuer?

We do not believe that the recently-adjusted CIA interest-rate standard for commuted values, which has, overall, tended to reduce solvency liabilities, needs to be changed further at this time.

With respect to surplus, it is clear that, in defined benefit plans, risks are shared by all – plan sponsors, members and beneficiaries. It is, therefore, fair and equitable that surplus be shared when plans are wound up or partially wound-up. The process could be expedited by requiring strict time limits for surplus-sharing deal to be struck, which, if unsuccessful, would be followed by binding arbitration. Simply increasing employer access to plan surplus would have no positive effect on coverage, and pension plan funding

### Requiring Full Funding on Plan Termination

It has been over a decade since the government promised to amend the PBSA regulations to require solvent employers to fully fund terminated plans. It is long past time for the government to follow through on this commitment, and amend the Regulations to bring the PBSA in line with most other Canadian jurisdictions. It is reasonable to allow a sponsor five years to meet these obligations.

In the event of employer bankruptcy, pension obligations should get preferred status in the allocation of remaining corporate assets.

We do not believe that the parties should be allowed to “contract out” of this requirement. Typically, pension plans are terminated at a time when there is a great imbalance of power in the favour of plan sponsor/employer, and no equitable deals could be expected in such a situation.

An important complement to a full funding requirement would be a pension benefit insurance fund, financed by a levy on pension funds.

### Partial Termination and Vesting

Under the PBSA, members affected by a partial windup are to be dealt with in no worse a fashion than members affected by a full windup. In its Monsanto decision, the Supreme Court of Canada affirmed that this required not only immediate vesting, but also a distribution of surplus, based on the rules previously enunciated in its Schmidt decision of 1994. It rejected the notion that this somehow impaired the rights of ongoing plan members. The requirement of surplus distribution on partial windup should continue in force.

The PBSA should require immediate vesting in all plans, as a matter of basic equity.

It is important to retain partial windups, even if immediate vesting were a general requirement and surplus distribution were not required. A partial windup report allows the plan sponsor and the regulator to assess and respond to questions relating to the ongoing viability of the plan when there is a major downsizing.

### Disclosure of Information

All plans should be required to have a Statement of Funding Policy and this should be available to all plan members, plan beneficiaries and their representatives. Annual statements to members should also report company contributions and company contribution holidays in the preceding year.

While there are arguments in favour of extending annual reporting requirements to deferred vested plan members, it is very difficult for pension plan administrators to maintain up-to-date addresses or contact information for such members, so that annual

mailings might prove to be an expensive but largely futile exercise. Access, electronic where possible, to all plan information should, however, be available to deferred vested members.

Members, beneficiaries and their representatives must also be guaranteed access to all correspondence and interactions between OSFI and plan sponsors and their agents. As we have noted earlier, the regulator has tended to act as if it has no obligation to include plan members, beneficiaries and their representatives in the decisions affecting their pension rights.

### Contribution Holidays

A policy on contribution holidays must be part of each pension plan's funding policy. We believe that there should be a legislated safety margin of 5 or 10% required before contribution holidays can be taken. Contribution holidays should not be allowed to bring the fund below the safety margin.

A requirement for plan member/union approval of contribution holidays would provide an additional level of security.

There remains the problem of sponsors taking contribution holidays based on outdated valuations. Restricting contribution holidays to the year following the filing of a valuation will put some limits on the potential damage.

OSFI has some ability to predict which plans no longer have surpluses, but plan actuaries should be best placed to inform employers and OSFI when contribution holidays are no longer appropriate. This should be made an explicit responsibility of plan actuaries.

### Void Amendments

The solvency valuation is only one measure among several which would indicate whether plan amendments are prudent. The proposed 85% rule is too rigid and creates practical problems. Solvency valuations can be volatile. In collectively-bargained plans, improvements are often negotiated, and the solvency of the plan is determined later. The proposed rule could essentially freeze the benefits of plans which may be well-funded on a going concern basis.

If the proposed 85% rule had been in place over the last decade, it would have done little to avert current problems. Plans which are in difficulty at this time are there largely because of changes in markets and interest rates that had nothing to do with the benefit policies of particular plans.

## DEFINED CONTRIBUTION PLAN ISSUES

### Safe Harbour Protection

We cannot support changes that reduce the plan sponsor's responsibility to deal fairly with plan members, either through safe harbour provisions, or a reduction in the standard of care (below). The plan sponsor's obligations to plan members go beyond the appropriateness of default investment options – to the selection of investment managers and service providers, the level and disclosure of fees and other responsibilities. These obligations must be taken seriously.

#### Retirement Payments Paid from the Pension Fund

The payment of variable benefits from the pension fund is a reasonable option.

#### Standard of Care

There must be no reduction in the standard of care required of plan administrators. Particularly in the light of the potential for conflicts of interest on the part of employers/administrators, the highest level of responsibility is required.

#### The Use of Surplus in DC Plan Components

Surplus generated in the DB component of a hybrid plan is no different from the surplus in a strictly DB plan, and should be subject to the same rules with respect to contribution holidays and use of surplus.

The Discussion Paper (p.20) incorrectly says that surpluses do not exist in DC plans. This is inaccurate. DC plans can and do have surpluses, either from the contributions for non-vesting participants, or for other reasons. It should be made clear that the plan sponsor has a duty not to “manufacture” surplus artificially by, for example, converting the DC balance to an annuity on a less-than-full-value basis.

#### OTHER ISSUES

##### PBSA Flexibility

We believe that before extending the range of the PBSA to member-funded or jointly-sponsored plans, there should be wide-ranging discussion of the requirements of such plans, particularly with respect to ensuring true joint governance with plan members.

##### MEPPs

For union-run or jointly-controlled MEPPs, it is reasonable that, while solvency valuations continue to be performed to assess the potential impact of dramatic changes, actual funding be required only on a going-concern basis.

With respect to large, pooled DC arrangements, there are currently no clear legal impediments to the creation of such funds. While there may be value in a the

development of an alternative that undercuts the exorbitant fees that Canadians currently pay for their DC/RRSP/Mutual Fund investments, such a scheme is unlikely to significantly increase coverage or retirement income to those most in need. The government's focus should be on improving the benefits provided by its current menu of programs – OAS, GIS and CPP, which provide the most effective and cost-efficient means to meet the income needs of most Canadians.

### Investment Rules

We are very concerned that the “migration” from a legal list to a prudent person approach to pension fund investment is heading towards full deregulation, at a time when the weakness of the prudent person approach have been amply demonstrated. We have seen many prudent persons, operating in large, apparently sophisticated institutions and pension funds, making highly-leveraged investments, often in near-total ignorance of the basic nature and risks of such investments.

In fact, we need to be moving towards a more effective re-regulation of pension fund investment, with an emphasis on transparency, and limits on opaque and leveraged instruments. These rules should be developed through a broad public discussion. As well, the regulator must have the capacity and resources to effectively oversee these rules.

Finally, we would like to reiterate our desire to be part of the consultations that will consider the detailed legislative changes that may follow this initial consultation.