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By email: pensions@fin.gc.ca

Dear Ms. Lafleur:

This letter is to provide comments on the Department of Finance consultation paper on *"Strengthening the legislative and regulatory framework for private pension plans subject to the Pension Benefits Standards Act, 1985"* dated January 2009. My comments in this letter are restricted to those issues that I view as the top issues. In addition, I have added comments on some, but not all, of the other issues touched on in the consultation paper.

From a strategic and policy perspective, the ultimate goal of the Department of Finance must be the strengthening of private pensions. Indeed the consultation document states: "One of the main purposes of the Act is to set out minimum standards for federally registered pension plans to ensure that the rights and interests of pension plan members, retirees, and their beneficiaries are protected." It is important to understand, however, that in order to achieve this goal, the plans and the sponsors of these plans must be sustainable given the economic, business, and competitive environments within which the plan sponsors operate. Herein lies the challenge.

The top issues that I believe merit comment in this letter are as follows:

- A. The rules for funding solvency deficiencies - proposed temporary funding relief allowing plans to extend their solvency funding schedule to 10 years from 5.
- B. The solvency calculation itself – the discount rate that is to be used in the determination of a plan's liabilities for purposes of the solvency test.
- C. Contribution holidays - The 10% pension surplus threshold over which employer contributions to a defined benefit pension plan must generally be suspended (on pages 6 and 13 of the consultation paper).

On March 22, 2005, I wrote a letter to OSFI to outline my concerns with one-size-fits-all solvency test requirements. Soon after I wrote that letter, in May 2005 the Department of Finance issued a consultation paper for comment on these same issues. In August 2005, I wrote you to provide my comments. Many of those comments appear in this new letter.

A. The rules for funding solvency deficiencies - proposed temporary funding relief

I agree with changing the funding period for solvency deficiencies during these difficult economic times, but this funding period should be linked to the financial strength of the sponsor.

Prior to considering the question of the period for funding solvency deficiencies, I believe it is important to ask if the existing solvency test is an appropriate measure for determining the risk of plan termination. In asking this, it is important to go back to first principles and ask these further questions: What is the risk that needs to be detected and mitigated with a solvency test? What is the desired outcome? Does the solvency test mitigate these risks with the desired outcome? “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.”

Two things are happening today. Firstly, sponsors on shaky grounds are complaining that funding solvency deficits over a five year period will force them into bankruptcy. Clearly the sponsor’s bankruptcy affords no benefit security for employee members of that sponsor’s pension plan. Secondly, more and more companies are abandoning defined benefit pension plans for their new employees in favour of defined contribution pension plans.

Is the solvency test serving the basic principles as intended? There is something fundamentally wrong with a test that, when the circumstances really warrant extra protection for plan members (such as protection from the sponsor’s potential business failure), the regulator looks to relaxing the requirements. Relaxing requirements for funding solvency deficits when there truly is a high risk of termination makes a mockery of the test. Extending relief to less solvent sponsors is counter-intuitive to mitigating the risk. In the commercial world, most creditors would respond to such a risk by tightening credit, and not by allowing for payment over even longer terms. However, in certain industries, it is not uncommon to ask a customer that is a poor credit risk to provide a standby letter of credit to guarantee future payment.

Changing and improving the test to a meaningful test or sequence of tests that realistically assesses the risk of termination would be a better first step. There is an urgent need to move to a risk-based assessment of solvency to replace the one-size-fits-all test of solvency. Solvency should be determined relative to the financial health and long-term viability of the plan sponsor.

The question of sponsors in good financial condition continuing to perform solvency valuations is a contradiction – much like asking solvent going concern public companies

to periodically value their assets on a forced liquidation basis and asking shareholders to respond. Or like asking homeowners to value their homes on a forced liquidation basis in a down-market, and asking these homeowners to immediately come up with the shortfall and pay down their mortgage.

As an example of sponsors that are unlikely to become insolvent, it is highly unlikely that this airport authority, or any other airport authority in Canada, would cease to operate as a going concern and be unable to fund its defined pension liability requirements on a going concern basis. This airport authority has issued \$350 million in debt and enjoys excellent bond ratings as follows: Standard & Poors A+, Moody's Aa3, and DBRS A(high). Airport authorities that have rated debt in Vancouver, Edmonton, Winnipeg, Toronto, Halifax and Montreal all have similar credit ratings. The basis of these ratings is our unfettered and unregulated ability to raise fees when and if required.

What are the solutions to the solvency test dilemma? Without pursuing the technical, legal, and administrative questions related to the following, I would suggest the following:

1. OSFI needs the discretion to follow a principles-based approach to solvency assessment. It should establish a multi-step process of evaluating, first of all, the risk of failure or plan termination. If there is a higher than acceptable risk of failure, it would then be appropriate to determine the outcome of such a failure with a solvency calculation.
 - As a first step, evaluate the financial vulnerability of the plan sponsor. For example, if a plan sponsor is a crown corporation or a debt issuer with an A credit rating or better from Standard & Poors, Moody's, or DBRS, it is not likely that this sponsor will fail in its obligations to continue funding its pension plan in the medium term.
 - Enquire as to the sponsor's future plans to terminate the plan.
 - If the sponsor intends to continue the plan and the sponsor meets the criteria of strong financial footing, then a course of action regarding solvency payments would not be necessary.
 - If the sponsor intends to terminate the plan, irrespective of the sponsor's financial strength, this may lead to an immediate course of action with regards to solvency payments. These could be laid out in a formal plan of termination that would be due well in advance of the planned termination date (say 2 years) and that would be reviewed by OSFI in light of the sponsor's financial condition.
 - Determine a course of action regarding solvency payments if the sponsor is experiencing financial difficulty or is otherwise highly vulnerable financially, depending on the severity of this situation. If the solvency ratio is 90% or higher, no payments would be required in the first year. If after the first year after reporting there is an improvement, no payments would be required in the next year, and this would be assessed each year. If the ratio is between 80% and 90%, payments might be required over a ten year period. If the solvency ratio is below 80%, payments might be made over a 5 year period.

2. Allow sponsors other means to guarantee pension plan solvency deficits when appropriate (that is, when it is necessary to do so because the plan sponsor does not meet the financial vulnerability test). This could be done with instruments such as letters of credit. Such letters of credit should contain appropriate terms and conditions to ensure the protection of pension plan benefits for the duration of time that a solvency deficit exists.
3. If solvency conditions prevail or deteriorate, consider solvency payments to amortize the shortfall, but this should not be done over an extended 10 year basis. Rather, if these conditions are truly serious, the amortization of the deficit should be done over as short a period of time as possible. With such an increase in risk, I oppose extending the solvency funding period to 10 years as this would not be consistent with “ensuring a level of benefit security for plan members”. Even 5 years to fund a solvency deficit is not consistent with the premise that the plan may be terminated in the short term. The regulator needs to be involved in these circumstances to exercise judgment to ensure that the solvency payments themselves do not expedite the financial failure of the sponsor.
4. How then does the regulator protect plan members from the possible demise of the plan sponsor and “ensure a level of benefit security for plan members” without driving the sponsor into bankruptcy? In the event of bankruptcy of the sponsor, pension liabilities should rank ahead of other secured creditors in the disposition of the estate of the bankrupt. The liability for special solvency payments should be on the same secured basis as the liability for amounts withheld from employees and the related normal contributions by employers as defined by section 81.5 of the *Bankruptcy and Insolvency Act*.
5. The Government of Canada should provide an alternative vehicle for investing and managing assets of terminated pension plans (as it now does with Canada Pension Plan (CPP) assets). In the stress of plan termination, the prudent plan member should not be investing his locked-in pension assets in long-term fixed income securities or insurance companies providing suboptimal returns, but should be investing in a suitable balanced mix of assets that suits his situation. The Government of Canada needs to step in, and provide special guidance or assistance to plan beneficiaries, or establish and manage a special investment fund for all of these assets (as it now does with CPP assets).

B. The solvency calculation itself – the discount rate that is to be used

I believe that the current requirement that bases the discount rate on a long-term Government of Canada bond plus an adjustment factor is not appropriate.

Low interest rates are the current problem – in the short history of solvency calculations, we have never ever seen interest rates as low as they have been over the last few years. I understand that actuaries are given no flexibility to consider the circumstances. Instead,

they are driven to make assumptions for the solvency valuation of pension liabilities based on today's requirement that existing assets will be invested in long-term fixed income assets (life insurance policies).

Long term interest rates are the lowest they have been in over 40 years. What happened in the 1960's, the last time that interest rates were this low? Pension plans were generally in their infancy in the 1960's, and for that matter, the solvency test did not come into existence until the late 1980's, early 1990's. There are alternative investment vehicles for terminated pension plan assets, and these should be considered in determining rates of return for calculating NPV of pension liabilities.

Our company pension plan recently had a case which illustrates that it would be more reasonable to use a blend of returns for a suitably balanced mix of assets as an estimate. Recently, an ex-employee and member of our Defined Benefit Plan who was not yet drawing a pension passed away in an accident. His estate (an ex-wife) received the proceeds of his plan assets - calculated on a solvency basis using the prescribed low interest rate. We were required to top-up the DB fund for the related solvency deficit. The funds were deposited into a locked in plan, but of course the beneficiary is now earning a yield based on her selected asset mix tied into market conditions, and not the suboptimal return inherent in calculating the distribution of the assets out of our DB plan.

C. Contribution holidays - The 10% pension surplus threshold

The Income Tax Act requirement that sponsors take a contribution holiday when the plan surplus reaches 10 percent on a going concern basis should be repealed and greater flexibility should be given to plan sponsors to act responsibly. As the Consultation Paper has noted, forced contribution holidays may leave pension plans exposed to unexpected deficiencies resulting from declining interest rates used to value plan liabilities, poor investment returns on plan assets, or both.

Other issues

In addition, the following are comments on some, but not all, of the other issues outlined in the consultation paper.

Requiring full funding on voluntary plan termination (page 9 - 10)

I agree that when a plan is voluntarily terminated, plan sponsors have a moral obligation to fully fund the benefits, but this could be done over a 5 year time horizon or other period of time linked to the financial condition of the plan sponsor as I have noted above. If this legislation is to be for the protection of employees, in particular when the sponsor faces bankruptcy, I believe that the outstanding obligation should be treated as secured debt of the company.

Statement of Funding Policy (pages 11 - 13)

I do not believe such a statement is necessary as funding is a matter dictated by law and interpreted by actuaries. Do not encumber legislation with rules and regulations, but



rather, outline principles of good, open and transparent disclosure. I do agree that it would be good practice to disclose exceptions to the funding norm to plan members, such as contribution holidays. I agree that retirees and former members who still have a vested interest in the plan should be provided the same solvency ratio disclosure as active members.

Variable retirement benefits directly from the defined contribution account

I am not opposed to allowing variable pension payments from defined contribution accounts, even if there is some additional cost and administration involved, but offering this benefit should be at the option of the plan sponsor. This provides for an additional option for DC plan members upon retirement.

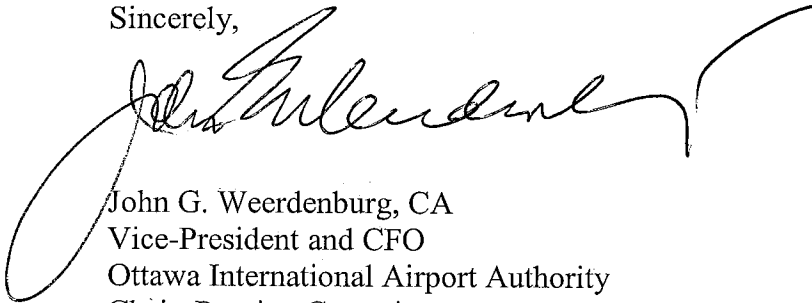
Investment rules

I do not believe that the Government of Canada should add investment rules. "Legal list" rules are limited by the state of the art on the day they are written, and may not contemplate valid investment vehicles that may be available in future. Pension legislation has migrated exactly as it should to a more principles-based prudent portfolio approach. The problem with rules is the loopholes that rules create. If the rules are silent (might the old rules have been silent in the past about asset backed commercial paper?), then the implication is that the investment is ok.

If you have any questions on this letter, please do not hesitate to contact me at 613-248-2000 extension 1107.

I hereby also give my express permission to post these comments on the Department of Finance website.

Sincerely,



John G. Weerdenburg, CA
Vice-President and CFO
Ottawa International Airport Authority
Chair, Pension Committee