



“STRENGTHENING THE LEGISLATIVE AND  
REGULATORY FRAMEWORK FOR PRIVATE  
PENSION PLANS SUBJECT TO THE PENSION  
BENEFITS STANDARDS ACT, 1985”

**RESPONSE**

**TO**

**FINANCE CANADA DISCUSSION PAPER**

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## Executive Summary

The retirement income security provided to Canadians is most likely one of the best in the world. The “Three Pillars” philosophy has stood the nation in good stead. Two of the Pillars continue to perform their stated mission viably. Unfortunately, the viability of a large portion of the “Third Pillar” is under significant stress. In particular, many of the Defined Benefit Plans within the Registered Pension Plans sector are severely under funded and place the income and livelihood of a significant number of Canadians at risk.

The current economic turmoil, market volatility, and sponsor concern for short term viability creates an uncertain and unsatisfactory condition to the sponsors who require elements of certainty in their operational expenses and for the plan members and retirees an environment of concern and worry with regard to their income and livelihood at a time when they should be able to rest in their twilight years.

The Government is to be truly commended for initiating actions to Strengthen the Legislative and Regulatory Framework of these Plans. Now is the opportunity to design and implement a paradigm change in a critical sector of the nation’s social structure.

The Air Canada Pionairs recognize the magnitude of the task and that it may take a period of time to accomplish. This submission was developed to respond to the reform requirements in the medium and long term. We would be remiss if we did not recognize the immediate concern of some plan sponsors (such as Air Canada) whose financial viability and ability to meet pension obligations are severely threatened. This situation results not only from the current world downturn (which has a multiplying effect on airlines) but also the loss and sale of revenue generating assets by a third party having controlling interest. In this regard, the Pionairs would therefore support reform in two parts.

### Part 1: Near Term – Temporary Emergency Solvency Relief Regulations

The development of a ten year solvency relief regulation in 2004 allowed Air Canada to exit CCAA. This regulation formed the basis for the “Temporary Relief Regulations” of November 2006, all of which benefited the sponsors while increasing the security risk to pension members and retirees. These regulations were, however, extremely useful as short term actions to assist sponsors in maintaining operational viability. We not only commend the Government for putting them in place, but also recommend that these regulations be maintained for future potential use as required.

The Pionairs support for Air Canada:

- The extension of solvency payments to 10 years. The requirement for full membership approval as defined in the “Temporary Regulations of November 2006” should be waived on a one time basis. Since “time is of the essence”, we believe that because (a) our members had approved such a measure on exit from CCAA in 2004 and (b) the current solvency deficit is

- Asset smoothing continue to be permitted as defined in the Government January 2009 Discussion Paper.
- Revise the discount rates used to calculate solvency reliabilities while maintaining these rates in close proximity to rates available for acquisition of annuities as defined later in this paper.

We recognize that last two issues create a virtual solvency ratio which may or may not be fully accurate in predicting the future. However, there is a need to benchmark the solvency of pension trust funds and both the actuarial and going-concern calculations provide such a benchmark. Without doubt, the above concessions will increase the security risk to income for retirees. We would therefore recommend that the Emergency Temporary Regulations also include:

- Increased responsibility and authority to OSFI for oversight of sponsors using these Emergency Regulations and that OSFI have the ability to prevent or reduce (a) any sale or disbursement of company assets during the period by the company or third party which has controlling interest in the sponsor unless it can be shown to provide substantial financial benefit during the term of these regulations and that this action will also benefit pension fund solvency; (b) any enhancements to the pension plan.
- All of the above are designed to assist a sponsor in remaining “going concern”. In the event of sponsor failure (even with the above relief, many sponsors have not been able to survive CCAA/bankruptcy), the Government should confirm to members and retirees that their pension income will be maintained either through takeover by a Government Agency, a back-up insurance to cover any individual shortfall, or other financial process as appropriate.

## Part 2: Medium and Long Term Reform – Issues Requiring Some Deliberation and Consensus

Standardize a set of temporary measures which may be employed at OSFI’s discretion to assist both a sponsor’s short term (e.g. a credible recovery plan must exist) viability while protecting the long term security of the Pension Plan.

- Current Finance Department proposal for asset smoothing is acceptable.
- OSFI be required to interpret and implement all laws and supporting regulations to protect the rights of plan members and retirees.
- Establish a Government Ombudsman for plan members and retirees to ensure that OSFI is at all times operating in the best interests of plan members and retirees.
- Regulations be promulgated to establish a Pension Security Trust Fund into which would be allocated any surplus generated by the Pension Trust Fund.

- Any changes to provide solvency funding relief other than in (Part 1.) above have the support of active and retired members on an individual group basis.
- Disclosure information available to individual members and retirees be significantly enhanced.
- Solvency holidays be discontinued except in special circumstances defined by OSFI.
- Solvency ratio for Void Amendments be set at .95 so as not to introduce a facility by which plan viability may be degraded disproportionately.
- Significant revisions to the obligations of actuaries to retirees need to be brought about.
- Develop and redesign DB plans such that the probability of plan failure becomes non-existent. There are many examples of such designs available:
  - a) Take over of plans in wind up by a Government agency (temporary or permanent).
  - b) Create an insurance program to cover any pension plan shortfall on wind up.
  - c) Assimilate DB plans into existing Pillars, one of two of the income security systems.

## 1. Introduction

The Air Canada Pionairs is a federally registered not-for-profit organization formed over 30 years ago to promote communications and social activities among Air Canada Retirees who are dependent on the Air Canada Pension Trust Fund for retirement income. Since Air Canada's exit from CCAA in September 2004, Pionairs have monitored Air Canada's Trust Fund reports and performance. It advocates on behalf of 27,000 Air Canada retirees of whom more than 50% are Pionairs members. It is also a member of a growing network of pensioner groups – the Canadian Federation of Pensioners – that together represent some 100,000 retirees from across Canada.

The Pionairs sincerely appreciate the initiative taken by Finance Canada to bring about reforms to the Regulations and Legislation pertinent to the PBSA. Concern with the adequacy of the regulations were made evident prior to 2003 when at least one major corporation entered CCAA due, in part, to the weaknesses in the existing regulations and on-going oversight by the Regulator.

The Pionairs were contributors to the Finance Canada Discussion Paper “Strengthening the Legislative and Regulatory Framework for Private Pension Plans Subject to the Pension Benefits Standards Act, 1985”, issued in 2005. A primary purpose of the Pionairs is to assist in supporting Air Canada and its on-going viability. The Pionairs supported the Special Air Canada Regulations issued in 2004 and acknowledge the benefits to sponsors which resulted from issuance of the temporary regulations 7 November 2006.

### A. Canada's Retirement Income System

This submission addresses issues specific to Canada's “Third Pillar” of retirement security for the Nation's citizens. In nearly all cases these individuals have little or no recourse for their livelihood other than their DB/DC public/private pension plans as supplements to Pillars One and Two. Additionally, these are Canadian citizens who are often least likely to be able to maintain an adequate level of income should their “Third Pillar” fail or be terminated.

A fair solution is required to mitigate the increased risks to the security of the “Third Pillar” for retirees. The solution must not only be, but must be seen to be, fair to Canadian citizen retirees rather than mostly to sponsors, whose motives, whether contractual or not, are often at variance to pension members and retirees..

The planned series of hearings by Finance Canada create an opportunity for the Federal Government to legislate improvements to the PBSA and the Regulations comparable to the actions already taken by several Provinces (Alberta, British Columbia, Ontario, Quebec, and Nova Scotia). Both the responses to Finance Canada's Paper and the hearings on the Papers should bring about much needed pension reform and increased security to those of our citizens who least can afford to lose their pension security.

There is a need for a paradigm shift in how the Third Pillar is structured. It is required by sponsors so that they may have certainty with regard to their obligations in extremely volatile times and for plan members and retirees who depend on this Third Pillar for their livelihood.

## 2. Context

Pensioners have grave concern with respect to the role of the Government of Canada in regard to Private Pension Funds. The stated role as noted is “to ensure that the framework is appropriate and enables all parties to make informed decisions to ensure that RPP’s continue to meet their defined goals.

The Government of Canada agency responsible to regulate often fails to carry out its defined responsibilities to “protect the rights and interests of members of pension plans, former members and any other persons who are entitled to pension benefits or refunds under pension plans”, 4.(3) (b) and p.38 of OSFI 2008 – 2009 Report on Plans and Priorities. In addition, it has failed to have company Owners a) cease or refrain from committing any acts, or from pursuing any course of conduct, which could harm a Plan sponsor’s ability to continue compliance with a Plan Protocol, and/or b) perform such acts as in the Superintendent’s opinion are necessary to remedy the situation (PBSA s11(1).

### Recommendation

- a) **The Office of the Superintendent of Financial Institutions have the authority and be required to investigate, initiate and cause to be implemented those actions to achieve full solvency, not only with direct sponsors, but also controlling entities whenever a Pension Trust Fund solvency deficiency falls below 95%.**
- b) **OSFI, on all matters requiring interpretation of the law and supporting regulations, be required to protect the rights and interests of plan members and retirees.**
- c) **The establishment of a Government ombudsman for plan members and retirees to ensure that OSFI is at all times operating in the best interests of the plan members and retirees.**

The principles advocated by Finance Canada’s Discussion paper, while illustrative, do not adequately reflect the proportionate risk levels attendant to pension beneficiaries and sponsors. In virtually all cases, sponsors are corporate institutions having or who have had, significant resources to meet their negotiated obligations. The beneficiaries, particularly retirees, are often individuals (widows, single persons, low income families) whose only resource is derived from that portion of their negotiated lifetime earnings which become their pension at termination of active employment. Allowing corporate entities to disburse funds and subsequently fail to provide adequate funding to support viable pension plans is morally and socially inappropriate and places a disproportionate risk on the individual.

## **Recommendation**

**The acquired rights of individual retirees be recognized and enshrined in the legislation consistent with their rights to the full benefits negotiated with their Plan sponsor during their employment lifetime.**

### **A. Former Crown Corporations**

Over the last two or more decades, a number of Crown Corporations were sold to the public, venture funds, pension funds and other private firms. These sales more often than not resulted in very substantial funds being returned to the Government. During these sales, little attention appears to have been devoted to the on-going pension fund risks and security due to change from Government Sponsor to private equity Sponsor. A large majority of former Crown Corporation employees are now retirees from a private pension fund whose sponsor's priorities vary significantly from those of the former Crown Corporation generally to the detriment of the former Crown Corporation retirees. It must be noted that those individuals whose careers were initiated in the late 1960's and 1970's most likely spent a greater percentage of their careers as members of Crown Corporation Pension Plan but no longer are accorded the rights and benefits which they had acquired over most of their productive career.

## **Recommendation**

**The Government of Canada take note of the above anomaly in the treatment of its citizens and former employees and enact such regulatory revisions as necessary to ensure the rights their retirees acquired as members of Crown Corporations Pension Trust Funds are honoured.**

### **B. Security of Pension Funding**

There is a requirement to reduce the risk and increase the security of Defined Benefit Pension Plans. This is exacerbated by the fact that many Defined Benefit pension plans have now matured to the point where the number of retirees and former members is approaching or exceeding the number of active members.

The widely accepted notion that it is acceptable for a pension plan to have a solvency deficiency sets the wrong expectations and may have negative impact on pension plan administration, create a false sense of asset availability in a corporation, mislead the actuaries. Recent events confirm that sponsors often use all available cash to fund on-going operations with little concern for the debt owed to the pension plans they sponsor. In fact, great pressures have and are being applied to the regulators to ever increase relief for under funded pension plans. They include:

- Extending solvency relief periods
- Smoothing asset valuations over time
- Changing the discount rate

- Changing the date for valuation
- Etc.

All of which, (such as extending the period during which a solvency deficiency can be made up) only exacerbates the problem and increases the risk and lack of security for the members and retirees..

There is a need to provide ample opportunity and agreement to fund beyond the full actuarial solvency requirement.

### C. Pension Surplus Threshold

The uncertainty as to who owns DB pension plan surpluses is, as subsequently defined, not just an impediment to the appropriate funding of DB plans. It is a critical factor in the survival of DB pension plans. Unless it is clearly established that federally regulated DB pension plan surpluses belong solely to the plan sponsor, few, if any, new DB plans will be established and the number of existing plans will continue to decline through sponsor insolvency and plan windups.

Over the last several years, the issue of plan viability has not so much focused on plan surplus but rather on lack of solvency. This may largely be due to the inability or lack of motivation on the part of plan sponsors to make contributions of sufficient magnitude to achieve a 20% surplus and the restrictions imposed by the CRA. In good economic times, plan sponsors often generate significant profits to operations which many, as good corporate citizens, would contribute in excess of the current nominal 10% providing it was reasonable to do so. One of the ways by which corporations could be enticed to make greater contributions would be by:

- Creating a separate pension reserve fund
- Setting a minimum funding level for the pension reserve. This minimum would be the amount required to be set aside for adverse cyclical deviation, as determined by plan actuaries' experience with plan members and retirees (based on existing economic conditions 20% - 25% would be warranted). The plan reserve account must never be allowed to fall below the minimum.
- The plan actuaries, with input from plan members and retirees, would also establish a pension reserve maximum funding level for each defined benefit plan. This would include consideration for the short and medium outlooks for Canada's economic and financial cycles, the relative maturity of the plan, the financial forecasts for the sponsor's business, etc.
- The current funding limits in the Income Tax Act need to be withdrawn completely.
- The reserve fund would be the source of additional funds required to keep the main pension plan fully funded at all times. Any excess funding in the main account would be transferred to the reserve fund.
- The reserve fund is to be considered part and parcel of the whole pension plan and protected in law as such. Funds in excess of the upper reserve limits in the reserve fund may be withdrawn or otherwise used to enhance

pension benefits, but only with the prior agreement of all parties who have contributed directly to the reserve with appropriate notification to the regulator and the CRA.

- Revise the Charter of Actuaries to ensure they are neutral agents and are responsive equally to the requirements of all stakeholders.

## **Recommendations**

### **Pension legislation be enacted to establish that DB plan surpluses have a balance as defined above following which the surplus would belong to the plan Sponsor.**

#### D. Temporary Funding Relief

The requirement for temporary funding relief and the necessity to provide measures to maintain the financial viability of sponsors in these economic times is understood. It is critical, however, in the rush to reduce artificially the measure of actuarial solvency deficiencies, that the impact on the risk and security of pension plans be minimized. In particular, if solvency deficiencies measurements are to be relaxed artificially by:

- Asset value smoothing
- Change to discount rates to minimize the sum of liabilities
- Solvency payment extensions

Then certain caveats must also be in place to assure the surety of the pension plans and payments to the members and retirees. Considering that even though members and retirees approve the relief, there is, in a number of industries, a good possibility that the sponsor will fail and the pension plan wind up. In this instance, its value and the value of any annuities which may be acquired in lieu of the plan payments will be significantly less than if the relief measures had not been granted.

To provide a measure of balance, plans taking advantage of the relief regulations should be required to:

- Provide quarterly valuations of the actuarial plan solvency so that member, and retirees representatives may track and alert the regulator to any adverse financial events occurring to the sponsor raising the attendant financial risk to the fund
- The use of LOC's to fund DB pension deficits supports the ownership of plan surpluses. If DB pension plan surpluses are owned by the plan sponsor, those surpluses should not be trapped in the pension fund as a result of investment or discount rate volatility. Allowing properly structured LOC's to fund DB pension deficiencies can partially address that issue. On the other hand, investment and discount rate volatility can give rise to funding deficits just as quickly as they gave rise to a funding surplus. In such circumstances it no longer makes sense to require that valuation reports, as a general rule, be filed only every three years. Once a plan sponsor elects to use LOC's, the general rule should become that valuation reports must be filed every year – more frequently when it is evident that

volatility may have generated a deficiency subsequent to a LOC being withdrawn.

- All sponsors be required to provide irrevocable letters of credit which would rate in priority before any and all other creditors in a sum equivalent to 50% of the difference between the solvency as measured and the 100% of the plan requirements and that for the balance, member and retirees be classified as having a super priority in the BIA and pass ahead of any and all creditors in the event of sponsor CCAA or bankruptcy in the same manner of member contribution made prior to bankruptcy, unpaid salaries, or other unpaid pension obligation claims.
- Maintenance through the relief period of special payments
- Restrictions on plan enhancements and any asset distribution to stakeholders.
- Direction to regulators to be proactive in their responsibilities for pension security assessment and enforcement.

### **Recommendation**

**That properly structured LOC's be permitted to fund DB pension deficiencies and that as a general rule valuation reports be filed annually once a plan sponsor elects to use LOC's for that purpose, and more frequently when circumstances indicate that a deficiency may have been created because a LOC has been withdrawn from a plan. These regulations also be applicable to companies holding major ownership in pension sponsor companies.**

### 3. Issues for Discussion Pertaining to Defined Benefit Plans

#### A. Solvency Measurement and Funding Rules

In times of economic turmoil there is a requirement to be able to benchmark, on a continuous basis, the financial health of defined benefit pension plans. These benchmarks not only provide an assurance to the members and retirees of the plan viability, but may also provide insight to all stakeholders the financial health of the plan sponsor. One such measurement “the funded status of a pension plan based on the sponsor being a going concern (will not fail)” is inadequate in the event of a sponsor having marginal operating margins in a cyclically threatened environment (e.g. airline industry). Of much greater significance is the actuarial solvency ratio which is a measure of the assets to all liabilities should the plan be instantaneously wound up (CCAA/bankruptcy).

Unfortunately, as referenced above, this benchmark is fully dependent on the elements used to determine future values and hence is subject to manipulation. The government should set stringent and enforceable rules such that artificial manipulation of this benchmark is restricted. The discount rates used to determine the value of the pension sum must be in close proximity to the rates available to obtain member and retiree annuities or equivalent long term investments. Otherwise, this measure will not fulfill its intended purpose and the member and retiree may find themselves bereft of the financial assets the government had committed to regulate.

Having large variances between discount rates and annuity interest rates can only result in an artificial solvency valuation and an individual pension value inadequate to achieve the payment stream originally promised and foreseen by the member. If the Government is to manipulate the discount rate to the benefit of sponsors so then must it implement a backup payment plan to service the gap between these artificial discount rates and those obtainable for annuities, or other long term investment vehicle.

#### **Recommendation**

**The discount rate allowed to be used to calculate liabilities for DB pension plan valuations be varied to include bond rates other than just Government of Canada bonds during recessionary periods and be consistent with the rate available to investment vehicles should a pension plan be wound up.**

In seeking to provide alternate means to relieve solvency deficiencies, the provision of irrevocable LOC has been approved in some provinces. These can be satisfactory so long as they stand and cannot be challenged by any creditors. In addition, their use in combination with manipulated discount rates presents, once again, an opportunity to have inadequate risk and security protection to the pension corpus.

Ultimately, the Government should consider alternate means to backstop sponsor failure and insolvent pension plans. One such alternative is to establish an insolvency insurance

plan which would only be implemented in the event of a sponsor wind-up or a sale, which has as a condition of sale the pension plan wind up. Funding for such a plan could be funded by assessment of public service pension plans (funded by taxpayers) and all private pension plans (also funded by members who are taxpayers). In this manner, the cost of the insurance would be equally born by all members and may be called upon on wind up or sale of the sponsor at essentially no cost to the Government.

Should a sponsor elect to use a Letter of Credit to make up a solvency deficiency, there is a requirement to ensure its enforceability so that it is not simply a comfort device. We are not aware of the use of an LOC being tested legally. Therefore, legal opinions must be provided confirming that the letter a) is irrevocable until such time as the purpose for which it is used is satisfied, b) cannot be challenged under any CCAA, BIA or PBSA conditions, c) becomes payable immediately to the Pension Fund Trustee on occurrence of any pension sponsor default or sale

In regard to the ownership of a pension plan surplus, this issue would be resolved if sponsors were required to fund plans to 100%. The CIA have recommended that the sponsor establish a Pension Security trust which would serve to top up any pension plan solvency deficiency below 95%. Whenever pension fund performance exceeds actuarial solvency, the overage be transferred to the Pension Security Trust. The assets in the Pension Security Trust would remain tax free. Should these assets exceed 25% of the actuarial solvency requirements of the Pension Trust Fund they could be withdrawn by the sponsor to the 25% level and be taxable. In the event of plan termination, all assets in the Pension Security Trust would be used to satisfy any actuarial solvency deficiency in the Pension Trust Fund to 100% and the remainder be available to the sponsor.

The current assets of many mature plans generally are made up of three (3) and at least two (2) components:

1. Funds provided by the sponsors as part of their doing business cost (securing, retaining personnel, etc.)
2. Funds provided in many plans by employee contributions.
3. Appreciation of fund value through creation of an investment portfolio.

For mature funds it is anticipated that 60%-70% of fund value is achieved through investment of the company/employee contributions. It is obvious that fund solvency probably results from investment performance which requires, on occasion, make up by the plan sponsor and not by the employees (there have been treatises written as to the ability of employees to achieve investment results equal to that of their defined benefit pension fund). In fairness, any surplus in excess of the security trust as noted above should be available to the sponsor on plan wind up.

The Pionairs believe that temporary Solvency Funding Relief Regulations include a requirement that “no more than one third of plan members, retirees, former members and beneficiaries object”. This is essentially a negative vote mechanism and generally assures passing of a sponsor’s amendment. The use of a majority of members, retirees,

former members would seem more appropriate for issues which have a significant affect on so many people.

### **Recommendation**

**Regulations be promulgated to establish, as part of the Pension Trust Fund, a Pension Security Fund into which would be allocated any surplus generated by the Pension Trust Fund. Any excess in the Pension Security Fund over 125% of the Pension Trust Fund would belong to the Sponsor.**

**Any changes to regulations providing solvency relief be approved in the same manner as in the 2006 Temporary Regulations.**

In addition to the ad hoc consideration provided to some individual plan sponsors (by extending the maximum period for funding DB pension plan deficiencies) there appears to be a need to establish more transparent and positive criteria which plan sponsors can rely upon when they face a need to extend solvency funding periods. Rather than simply relying on an automatic extension from five years to ten or even fifteen years as some sponsors have requested, criteria need to be established that would allow OSFI to consider the sponsors circumstances, and, in the process, require OSFI to consult with plan members and retirees. Appropriate criteria would include a determination of the financial viability and strength of the plan sponsor through to the end of any proposed extended funding period, the ability of the plan sponsor to generate cash, raise capital, or provide LOC's to meet funding requirements over the whole period, and the support of both active and retired plan members for the extension. If a plan sponsor cannot meet such criteria they should remain obligated to the existing five year funding period.

### **Recommendation**

**That the extension of solvency funding periods beyond five years be temporary and subject to financial criteria specific to the full extended period and to the support of active and retired plan members on an individual group basis..**

Further, reference to extension of the solvency funding period requires clarification for those sponsors who currently are in a five year recovery program. A. Does the 10 year solvency relief imply that 10 years may be added to the remainder (2, 3, 4 years) of the original for a total greater than 10 years. B. Can the solvency payment be made up of the remainder of the payments due to the original 5 year program and the additional solvency due to increased deficiency over the 5 year amount and be amortized over the new 10 year program. C. Must the new 10 year payment program be based on the total solvency payment requirements amortized over 10 years. D) Can LOC's be used for a portion of any of the above?

## B. Requiring Full Funding on Voluntary Plan Termination

Pension Plan members and retirees have a right to expect that the employment contract they agreed to with their employer, which included a Defined Benefit Pension Plan, would be fully honoured. Many Defined Benefit Plan members and retirees have established a livelihood, no matter how meager, based on their access to CPP/QPP, OAS, and their Pension Agreement. To terminate a plan at any less than full solvency will produce significant hardship and alteration of lifestyle. Many of these individuals live marginally at the poverty line (less than \$20,000/yr) even with the first two pillars intact. The Government does have a duty to ensure these citizens' annual revenues are not placed at risk.

- a) Significantly reduce what may be an already perilous lifestyle
- b) Force senior citizens into requiring additional financial support at taxpayer cost
- c) Allow malfeasant corporations to abdicate their contractual obligations.

In summary, in regard to unfunded termination of a pension plan, the Government has an obligation to senior citizens who have contributed through their taxes to the well being of the nation, and who no longer have the ability (see illustration 1) to rectify a revenue deficiency over which they had no control. The likelihood that a corporation entering bankruptcy will have sufficient assets available for an unsecured creditor (pension fund) is unsubstantiated. The proposal that a pension fund with unfunded solvency liabilities has the status of deemed assets has yet to be legally tested for its priority above all other creditors. The likelihood of a corporation in bankruptcy to have sufficient assets in any event to satisfy the unfunded solvency in a pension trust fund is also very unlikely. All of which necessitates that security of Pension Trust Funds and solvency must be continuously maintained. The only possible exception might occur provided the sponsor possessed adequate unencumbered assets to provide coverage of at least 125% of the solvency payment required. The sponsor must assign sufficient irrevocable and unattachable assets by any creditors, to the Trustee of the Pension Trust into perpetuity or until such time as the Pension Trust Fund is made fully solvent. This would require revisions to the PBSA, BIA, CCAA, and CRA.

## Scope of Retiree Quality & Security of Life

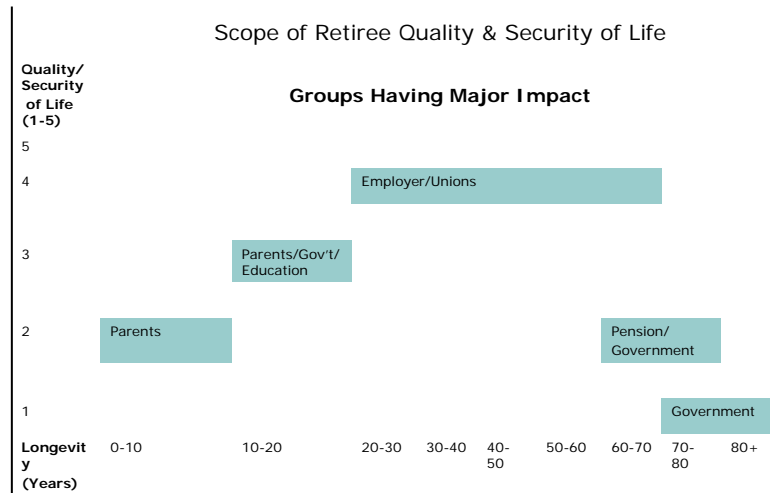


Illustration 1

As important as it is to ensure that plan members are protected from deficiencies when a sponsor voluntarily terminates a plan, a provision to require full funding on voluntary plan termination will simply mitigate against the establishment of new DB pension plans, whether or not a period of time after termination is provided to meet any deficiency. In most instances, it seems more appropriate for the plan sponsor and the plan members and retirees to have the ability to negotiate the final settlement condition of the plan and for the regulation or Act to accommodate the outcome of such a negotiation, which might well include an extended period for the plan sponsor to make up any deficiency.

### Recommendation

**That in the event of a deficiency on the voluntary winding up of a DB pension plan by the sponsor that the final settlement be established by negotiation with plan members and retirees and that the negotiated outcome be accommodated by the Act or regulation.**

#### C. Partial Termination and Immediate Vesting

Utilizing the rationale that major accumulation of value in Pension Plans (certainly mature plans) is attributable to investment growth, rewarding members of plan in partial termination with benefits beyond the average provided in good market conditions, and penalizing others in poor market conditions does not appear to be fair. Development of a termination process which would be equitable could be appropriate; however, doing so appears to be extremely complex. Regardless, applying a defined vesting period, particularly in this age where presently the average tenure in a corporation by an employee continues to decrease is reasonable.

#### D. Disclosure Information

To date, many Pension Fund sponsors fail to meet the criteria for information on pension funds, required by the Act. In their function, the regulators should be mandated to request from Sponsors that information disclosure to members, former members is being made on a regular basis. To facilitate the auditing of plan status and policies, Sponsors should be required to supply to non member, retiree representatives, all necessary information for these representatives to determine the Sponsor is in fact conforming to its commitments without the need of a court order mandate. A simple request from a former member, retiree group representative should be sufficient to illicit, in a timely fashion (30 days) all actuarial and other significant pension information.

#### **Recommendation**

**Information disclosure should be the following:**

- **Statement of Funding Policy.**
- **Statement of Investment Policies & Procedures**
- **Semi Annual Plan Valuation**
- **Changes to Plan Governance or other issues which may impact Plan operation and viability**
- **Semi Annual Financial Statements for the Pension Security Trust**
- **Key Indicator Report**
- **A triennial (or more frequent) certificate should be required from an independent third party who is qualified to pass judgment on the adequacy of the procedures and controls in place for administering the pension plan along with an opinion on the adequacy of the pension security trust fund level. This would need to be expanded to include an independent opinion on the actuarial review results.**

#### E. Contribution Holidays

Over the last decade, there has been sufficient turmoil in the financial/investment sector that many funds have not been in a surplus position, and also have had solvency deficiencies – in some instances leading to CCAA. Contribution holidays should be discouraged since, in many instances, such holidays have a) resulted in decreased pension reserves b) encouragement to utilize funds for other purposes whose long run impact further negatively affects pension liabilities.

To the extent such holidays are made dependent on achievement of full solvency and a Pension Security Fund which has the equivalent of 20% - 25% of the Plan solvency value In Trust as previously described, a contribution holiday in the year in which the target

value in the Security Fund is achieved and reported to OSFI, a holiday may be taken. To encourage effective management of the Plan solvency and Security Fund, repetitive holidays may be allowed provided the targets are continuously achieved.

These funding policies should be enshrined in the Statement of Funding Policy and the Income Tax Act should be revised so that contributions to the Security Fund are not taxable except if the company withdraws such funds.

## **Recommendation**

**That “contribution holidays” not be permitted to plan sponsors unless OSFI is satisfied that a solvency surplus currently exists in the pension plan (segregated into a Security Fund) sufficient to meet future plan liabilities.**

### **F. Void Amendments**

There was always a need for such a prescribed level. OSFI has long been aware of the dangers of allowing pension plan improvements to be made by the plan sponsor, often in lieu of salary and wage improvements, in the belief that the financial markets would provide for the cost and the sponsors operation would not be burdened.

The effect of allowing plan improvements to plans that have any solvency deficiency is that the improvement almost always shifts the balance of assets available from retirees (who are seldom the beneficiary of the improvement) to active employees. The proposed ratio of 0.85 is too low and is not a disincentive to sponsors using pension plan assets in lieu of operating cash to reward active employees.

While Pension Plan Trusts are essentially established as long term vehicles to ensure that the acquired rights of members and retirees are maintained, current financial events have demonstrated that free market volatility can have major impact on the financial capability of a Pension Plan Trust to meet its commitment. Solvency ratios have exhibited annual variances of 10% - 30%. In order for a Pension Trust Fund to maintain a level of assets sufficient to meet such financial environments, a solvency ratio of 0.85 is marginal and can only result in long term under funding in the event of a 20% variance to 0.65 and the attendant financial burden of solvency recovery on the Plan Sponsor. A manageable ratio would be in the order of 0.95 which would prevent variances such as are being experienced from financially crippling either the Fund or the Sponsor.

Setting a low solvency ratio in many instances may have the effect of setting a new benchmark to which many sponsors may target thereby reducing the whole intent of having a measurement which provides some indication of the Plan health, provided these actuarial values are not subject to inappropriate manipulation (discount rates, etc). We would recommend amending the regulation for this purpose to 0.95 to encourage corporations to fully fund their plans without marginal amendments.

Consideration might also be given to retroactive roll-backs to any improvement in pensions made in the three years before a pension plan is wound at less than full solvency or if a plan sponsor becomes insolvent with plans at less than full solvency.

Conversely, the desire to implement amendments for improving pension benefits should not be allowed to override prudent financial management of the plan. Amendments could be negotiated and agreed upon with members and retirees but should not be implemented as long as there are any pre-existing funding deficiencies and not until the improvements can be fully funded including any retroactivity.

### **Recommendation**

**That a solvency ratio level of 0.95 be prescribed for the purpose of implementing the void amendment provision in the Act, and improvement roll-backs be implemented retroactively in some circumstances.**

#### **4. Issues for Discussion Pertaining to Defined Contribution Plans**

##### **A Safe Harbour Protection for Qualified Default Investment Options.**

In Defined Benefit Plans, the Sponsor assumes the risk for funding full actuarial solvency of the plan. This is not an inconsiderable risk. In a Defined Contribution Plan the Sponsor assumes no such risk and consequently sponsor contribution is significantly less over time than a Defined Benefit Plan and the level of contribution is more predictable. Providing Safe Harbour to Defined Contribution Plan sponsors further encourages establishment of Defined Contribution Plans by further reducing sponsor risk. The pendulum is swinging too far. Sponsors of Defined Contribution Plans should be held accountable for the investment options they make available to their members and they should be expected to assume any and all risk with regard to the performance of these outside providers just as Defined Benefit Sponsors ultimately assume the performance risk of their selected investment providers.

##### **B Retirement Benefits Paid from the Pension Fund Options)**

It is particularly interesting that DC plan members have the option to elect either for a life annuity or transfer to an RRSP/RIF on retirement. Generally most opt for the transfer option. Yet retired DB plan members whose plan is being terminated with a deficiency (as could happen in the case of plan sponsor insolvency) are not given the choice of transfer to RIF, or other plan, but must accept an annuity, and that has the effect of permanently crystallizing their loss.

In today's investment climate, the option to accept a transfer to a RIF might allow some of the DB losses being experienced by retirees to be recovered at a future date. And, it would provide more flexibility for a retiree to meet short term income needs that an annuity does not provide.

There are survivor issues that need to be dealt with in moving away from having only an annuity option, but those can also be accommodated in a RIF environment. Retirees making such an election need to be compelled to obtain the advice of a professional financial planner/advisor.

Another option might be to allow consenting retirees to group their funds and move them into a fund, for instance, managed by the CPP. If fund performance permitted, the pensions of retirees might increase over time, something group annuities do not.

##### **C. Standard of Care Changes**

The proposal to reduce the already very limited responsibility of a DC sponsor (to make contributions and comply with the legislative and regulatory framework) from that of a fiduciary responsibility to one of "good faith" seems one more relaxation of responsibility for plan sponsors while doing nothing for plan members. It also makes less

attractive the creation or contribution of DB plans where a fiduciary level of responsibility is the standard.

The administrators who are relieved of major financial burdens under these plans should at least continue to be accountable for the investment vehicles they provide to their employees. Employers who have the interest of their employees enshrined in their operations will certainly meet the fiduciary responsibility test.

#### D. Use of Surplus in Defined Contribution Plan Components

Surplus funding in Defined Benefit Plans must first pass not only the full solvency test, but also the Pension Security Trust funding requirements prior to consideration of any disbursements to other venues. Essentially, the issue of Defined Benefit and Defined Contribution Plans needs to be separated, not integrated. The advantages to a hybrid design, while apparently advantageous to Plan Sponsor, by definition generally result in penalty to the Defined Benefit Plan members. Prior to undertaking any regulatory change, a full discussion by knowledgeable actuaries and accountants is required to outline to all stakeholders the benefits and liabilities.

#### E. Administrative Procedures

Any changes to these procedures will be dependent on the resolution of Standard of Care changes for Defined Contribution Plans.

## **5. Other Issues Respecting the Framework for Private Pension Plans**

### **A. Flexibility of the Pension Benefits Standards Act, 1985**

The expert panels commissioned by various Provinces have indicated their openness to alternate plan designs; however, on the whole they appear to mostly support Defined Benefit Plans. The ability to register new alternative plans should be based on individual situations and subject to approval by the administrator.

### **B. Multi-Employer Pension Plans**

No Comment

### **C. Simplified Pension Plans**

No comment

### **D. Distinction between Defined Contribution and Defined Benefit Plans under the Act.**

Inasmuch as the Finance Department initiative is to reform the Legislative and Regulatory Framework, there may well be recommended revisions put forward which would benefit by establishing clarity between the plan designs. Establishing those portions of the Act specific to each plan would in future assist in any particular revisions to each plan and thereby reduce the opportunity for confusion and litigation.

### **E. Investment Rules**

The surviving quantitative rules or limits should be revised and adjusted to meet the financial conditions which exist. Currently, a pension plan should not own more than 5% to any single entity and all of its investments should be widely allocated.

## **6. Additional Issues Requiring Reform**

### **A. Actuarial Enhancements.**

A Plan's actuary faces an inherent conflict of interest in being selected and paid by (although often from the pension fund) and reporting to the Plan Sponsor, rather than plan members. Regulatory aid is required to ensure the actuary's role, perspective and reporting relationship is more balanced between the plan sponsor and members (including active employees and retirees).

It may be argued that, in times of serious financial stress – both within the pension fund as evidenced by funding shortfalls and directly within the sponsor, there should exist a means to ensure that a plan's actuary clearly works in the interest of the plan members and sets those interests ahead of those of the plan sponsor.

There is a need to refine and define lines of communication directly between the plan actuary and retired members of the plan – currently there is no such mandatory link and retirees are largely in the dark on the plan's funded status.

Prevailing financial market volatility, and the consequent volatility of plans' funded status, requires improved timeliness and frequency of actuarial valuations. During the early 2000's meltdown, plan sponsors and members were, for example, still enjoying contribution holidays at a time when these plans were actually in serious funding shortfalls. Further, actuaries must wear added responsibility for an urgent "calling to account" when, because of financial market decline, interest rate drops, or the impairment of a sponsor's financial condition, the plan's funded status may have been reduced. In such circumstances, the traditional triennial valuation time-frame must be superseded.

### **B. Sponsor Bankruptcy and Insolvency**

There is a need to emphasize the financial exposure of members and retirees 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 even though, in many instances, they have been and are a sponsor's greatest creditor. This is anomalous 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.

### C. Defined Benefit Plan Viability

The concept that Defined Benefit Plans should continuously be subject to temporary solvency payment relief appears to be gaining sponsor acceptance. Financial turmoil has occurred during previously turbulent financial periods. It becomes apparent that ability by society to maintain this pension design requires more than partial rebuild. There are, no doubt, several ways to address the issue:

- a) Have a set of temporary measures available whenever there are financial events which place the plans at jeopardy,
- b) Restructure the plans so that the possibility of plan failure is non-existent
- c) Terminate the concept and establish a Universal Pension Plan similar to that which exists in some European nations.

The process currently being applied using submissions and hearings essentially satisfies proposal (a) with continuous random tweaking being applied as needed.

Restructuring the plan design to minimize or fully negate plan failure is feasible by using a taxpayer (e.g. plan members) funded insurance program to secure contracted pensions on sponsor failure. This approach could be done without excessive cost to the Government by assessing contributions from all the defined benefit plans nationwide, including civil service Defined Benefit Plans (whose wages and pensions are paid by the taxpayers) and private plans (who are taxpayers). The fund would be used to supplement full pension shortfall only on failure of the sponsor. Sponsors would be required to meet stringent funding requirements (e.g. Pension Security Trust) with management penalties to those not meeting these requirements. A different option could be to have the government take control of deficient plan on wind-up, etc.

The institution of a vertical pension plan as suggested by FSNA which would be a tranche of the CPP would satisfy the requirement of (c) while providing large integrated assets to support national objectives.

### D. Pension Plan Security in a Modern World

During the last two decades, there has been a continuous evolution of the world corporate structure. Specifically, identities have been established for the sole purpose of acquiring other identities, integrating or disintegrating the components and disbursing or structurally reshaping the corporation, more often than not based on consideration for profit rather than functional efficiency or individual benefit. Many of the acquirers label themselves as Venture Funds/Hedge Funds whose sole corporate purpose is to create wealth without regard to the deterioration which occurs to the identities under their aegis.

Concurrently, the rights of individuals and their livelihood, based on contracted agreements for retiree benefits have not kept pace. There is a need to introduce into regulation and legislation, the ability of a regulator to monitor and enforce pension requirements, not only on a sponsor but also on those entities who exercise control over

the sponsor even though those entities may have shrouded themselves legally from any responsibility to the plan sponsor except to extract revenue and assets.

The PBSA in these instances requires revision to include not only sponsors but also any entity, corporation or other body which exercises any aspect of control over a sponsor.

## **7. Conclusion**

There has been, for over a decade, a requirement to revise the Legislation and Regulatory Framework for Private Pension Plans. The increasing reduction in solvency and viability of these plans is largely due to the volatility and turmoil of the private sector. The need to protect the rights acquired by citizens through a lifetime of work is inherent in the nation's social responsibility.

The recommendations made cover what have now become emergency survival requirements for corporate existence. In the long term a paradigm change is required to provide the security of the income and livelihood of pension members and retirees.

The Pionairs have, as members, many professional, skilled and talented individuals (financial, pension, accountants, legal, administrative, etc.) conversant and knowledgeable with the many complex pension legislation and regulations issues addressed in the Government's request. We would be pleased to be of assistance, as retired individuals, to the Government in the development of initiatives to strengthen the legislative and Regulatory Framework for Private Pension Plans subject to the Pension and Benefits Standards Act, 1985.

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