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**A Retiree's View of DB Pension Plans under the PBSA, 1985
(Or, why we're lending Air Canada three billion dollars)**

Response to Finance Consultation Paper – dated January 2009

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

Submitted By:

Raymond H. Lindsay
PO Box 2127 Stn. Main
Sidney, BC
V8L 3S6
250 655 0585
lindsayinsidney@telus.net

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Submitter's Background

My name is Raymond Lindsay and I live in Sidney BC.

I am presently retired, have a civil engineering degree, and was member of the Quebec Order of Chartered Accountants for 25 years. My entire corporate business career was spent in management, most of it at the senior and executive management levels. Much of that time was spent at Air Canada where I was Treasurer during some of the years leading up to privatization. I've had considerable exposure to pensions. After leaving Air Canada for the private sector (the second time in 1992), I acted as a business consultant to Air Canada and to other clients in Canada and abroad on a wide variety of assignments.

When Air Canada filed for CCAA in 2003, Pionairs (the Air Canada retiree group) were appointed by the Court to represent the non-union pension plan members. I was appointed to represent the Executive Plan members. Air Canada unions represented their active and retired pension plan members throughout the CCAA process.

Since then, I have served on the Pension and Benefits sub-committee of Pionairs who monitor that Air Canada lives up to its obligations to retirees; keep Air Canada retirees informed on pension matters; and work with others on pension issues - in an Air Canada context, and with other national retiree organizations in a broader Canadian retiree context.

The views that follow though are mine. Pionairs are making their own representations.

I am concerned that:

- OSFI and Finance are insufficiently attuned to issues concerning retirees and are more focused on the views of pension plan sponsors and pension professionals.
- OSFI and Finance are not at all focused on the plight of retirees whose DB plan sponsors are at immediate risk of corporate insolvency.
- A Pension Summit (with retiree representation) has not been scheduled, as Finance seemed to be proposing in late 2008.
- OSFI will not use this opportunity to have themselves clearly designated as the independent overseer of federally regulated pensions, and instead remain as they are now an adjunct of Finance on whom they depend for legal opinions, other expert advice, and often for career opportunities within the civil service.

General Background

Many of the issues raised in the Consultation Paper have been before Government for the last decade and some were raised in earlier consultations with Finance in 2005.

Active and retired plan members of Air Canada pension plans made significant concessions to allow Air Canada to emerge from CCAA in 2004 - included salary and wage cuts for active members and the loss of pension indexation for retirees. The retirees' expectation was that Air Canada would return its pension plans to full solvency and that the pension regulatory environment would be immediately strengthened.

Yet little regulatory change has occurred since 2004 - despite annual visits to Ottawa by Pionairs to meet with OSFI and Finance; despite calls for action by the Pionairs and others for OSFI to act in situations where it appeared OSFI was obligated to do so; and despite the presentation of expert analysis to OSFI as to where this lack of action was leading in the case of Air Canada.

By early 2009, Air Canada's pension deficits had increased nearly threefold from 2004 - despite Air Canada living up to all its post CCAA pension obligations.

Over the years since 2004, Air Canada retirees have not advocated for handouts or bailouts from Government and continue to support regulatory changes that would help Air Canada avoid corporate insolvency in the face of business and pension pressures. The retirees are in effect lending Air Canada, interest free, their share of the \$3billion+ pension deficit. There is presently no floor on the losses that might be suffered by Air Canada pension plan members.

Better regulation alone would not have created a floor under those losses. But having better regulation, when it was needed, would have significantly reduced the losses.

Many retirees, in addition to Air Canada retirees, are more than ever concerned about the solvency of their pension plan sponsors and beginning to focus their attention on how to avoid at least some of the permanent and significant pension losses that will result if their pension plans are wound up (under current legislation) with large solvency deficits. Or on avoiding the losses that will result if pensions are reduced without the plans being wound up.

It is not Government or the Canadian taxpayer who are being asked to bail out DB pension plan sponsors who can't meet their pension and other corporate obligations. It is retirees on fixed incomes and active pension plan members whose jobs are at risk. Retirees need a much bigger voice on pension issues and they need an empowered and dedicated pension advocate and regulator. And as I've already said, OSFI is not, as matters now stand, that advocate or regulator.

Retirees - Maybe Faceless but Powerful

There are 27,000 or so Air Canada retirees - or the surviving widows and widowers of those retirees.

Many of them earned their pensions and retired prior to Air Canada being privatized by Government 20 years ago. None have had fully indexed pensions – not even before Air Canada was privatized. The partial indexation that Air Canada once provided was always at the discretion of the Board of Directors and was never more than half of COLA. Even that partial indexation stopped six years ago.

Almost all Air Canada retirees live in Canada, a lot of them on very small pensions. Hundreds can barely afford - with a combined Air Canada pension, CPP or QPP, and OAS - the care facility they live in. If their Air Canada pension is reduced because of an Air Canada insolvency or a mandated pension reduction, many will no longer be able to afford to stay where they now live.

There are also thousands of - more than I would like to try and identify – Air Canada retirees already at or below the poverty line and for whom things could get a lot worse.

There are very few Air Canada retirees who have 'big' pensions. Anyone who retired, even ten years ago, from a Government of Canada position (with a length of career, final salary, and job responsibility comparable to an Air Canada employee who retired at the same time) has a pension that is significantly greater than the Air Canada retiree. And the Air Canada retiree is the one who doesn't have a fully indexed pension guaranteed by the taxpayers of Canada.

The Air Canada retiree is the one who is lending their share of \$3 billion to Air Canada.

Maybe it's because I'm one of them, but I believe that Air Canada Pionairs who include about half of the 27,000 Air Canada retirees are the best organized and longest established retiree organization of this size in Canada. Many are on an email list and the rest easily communicated with. They retain legal counsel expert on pensions and insolvency and have the funds to act quickly in their own interest.

It makes sense to pay attention when they speak as a group or individually.

3. Issues for Discussion Pertaining to Defined Benefit Plans

A. The Government of Canada is interested in stakeholders' views regarding the rules for funding solvency deficiencies and the solvency calculation itself

A.1 Ownership of DB pension plan surpluses

The uncertainty as to who owns DB pension plan surpluses is not just an impediment to the appropriate funding of DB plans. It is a critical factor in the survival of DB pension plans in general. Unless issues such as ownership of plan surpluses are addressed, the DB plans that do survive will be seen as dinosaurs and lose the attention of Government just as they already appear to have lost the interest of business.

It must be clearly established that federally regulated DB pension plan surpluses belong solely to the plan sponsor or few new DB plans will be established and the number of DB plans will eventually decline through sponsor insolvency and plan windups.

Recommended: that pension legislation establish once and for all that DB pension plan surpluses belong solely to the plan sponsor.

A.2 Letters of Credit in solvency funding

The use of LOC's to fund DB pension deficits goes hand in hand with 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 give 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, and more frequently when it is evident that volatility may have generated a deficiency subsequent to a LOC being withdrawn and before the next report is due.

The standard of reporting for more frequent (than annual) filings might be reduced to avoid making the exercises more costly than is necessary for plan sponsors who can demonstrate they have financial strength and are able to restore LOC's. Relatively simple software and spreadsheets are available to plan sponsors to estimate pension valuation changes as frequently as they consider necessary. Many sponsors do not conduct such informal valuation exercises (or at least pretend that they don't) so as to avoid diverting operating cash to sponsored pension funds. The ability to use LOC's to fund deficiencies should alleviate some of that concern.

Recommended: 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 since a LOC was withdrawn from a plan.

A.3 Discount rate for solvency valuations

In the current economic environment, the Government of Canada is depressing Government bond rates to encourage the flow of investment to the non-governmental sector in the hopes of generating liquidity and credit in the general economy. That policy has the effect on DB pension plan valuations of increasing plan liabilities beyond what was intended when the standard for discount rates was established.

That impacts the solvency, not just of pension plans, but also of the plan sponsors themselves and it affects their ability to meet pension-funding requirements. There seems to be a need to address this issue on a temporary if not a permanent basis by allowing corporate bond rates (with lower bond ratings) to be factored into the rate for discounting liabilities – at least during recessionary periods like we are now experiencing.

Recommended: the discount rate allowed to be used to calculate liabilities for DB pension plan valuations be varied to include corporate bonds with lower bond ratings.

A.4 Funding periods for solvency deficiencies

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 certain criteria that 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. 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.

Recommended: that the extension of solvency funding periods beyond five years be subject to financial criteria specific to the full extended period and to the support of active and retired plan members.

B. The Government of Canada is seeking views on whether to require that plan sponsors fully fund pension benefits when a plan is fully terminated, but provide that payments can be made over a period of five years, and treat the outstanding obligation as an unsecured debt of the company. In addition, the Government is seeking views on conditions, if any, where a plan could be terminated in an under funded position by virtue of an agreement between the sponsor and plan members.

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 corporations establishing 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 to have the ability to negotiate the final settlement conditions 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 all or some deficiency.

Recommended: 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 that the negotiated outcome be accommodated by the Act or regulation.

C The Government of Canada is seeking views on whether to eliminate the concept of partial termination from the Act but require immediate vesting of pension benefits for all members.

I have no views on this issue.

D. The Government of Canada is seeking views on whether to:

- require administrators to establish a Statement of Funding Policy (SFP) in a similar fashion as the Statement of Investment Policies & Procedures (SIP&P). The SFP would be examinable upon request, like the SIP&P.**
- allow required disclosure items to be disseminated by electronic means, at the option of the receiving member or beneficiary.**
- expand the categories of members required to receive plan information to include former members and retirees, where it is appropriate.**

It is hard to imagine why anything less than full disclosure of funding policy as well as of investment policy to all pension plan members, active or retired, would be considered adequate. And not just on request, but as part of an annual disclosure statement. For many – sponsors, active and retired members alike - disclosure by electronic means has become the preferred means of communications. There will be little if any incremental cost to plan sponsors of providing additional information to active members, and for retirees the benefit

of the additional information will certainly outweigh the cost - which most plan sponsors, in any event, charge to the pension plan.

Recommended: that pension plan sponsors be required to establish a Statement of funding Policy in addition the Statement of Investment Policies & Procedures and that they be required to circulate those policies as well as solvency ratios to retirees.

E. The Government of Canada is seeking views on whether to amend the regulations to prescribe a solvency ratio level of 0.85 for the purpose of implementing the void amendment provision in the Act.

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 fund the improvements and the sponsors operations 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 to cover liabilities from the retirees (who are seldom the beneficiary of the improvement) to the 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. A ratio of 0.95 is more sensible.

Consideration might also be given to retroactive rollbacks 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. Had that been done at Air Canada in 2003 some of the plans might have benefited significantly.

{In the event that so called 'reserve funds' (in excess of the currently allowed 110%) are established from tax deductible sponsor contributions and if those 'reserve levels are not considered to belong the plan sponsor, then the solvency level before implementing the void provision would presumably have to be correspondingly adjusted upwards. For instance at reserve levels of 125% the solvency ratio level would be $\{(1.25 - 1.10) + 0.95\}$ = a ratio of 1.10}

Recommended: 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, and that if 'reserve funds' above currently established tax deductible levels are allowed and the reserve funds

are not considered to belong to the plan sponsor then the ratio of 0.95 be correspondingly adjusted upwards.

F. The Government of Canada is seeking views on whether:

- **plan sponsors be required to develop a formal policy on contribution holidays for inclusion in a Statement of Funding Policy; and**
- **to the extent that employer contributions are permitted under the tax rules, plan sponsors only be permitted to take a contribution holiday in the year in which a valuation report, filed with OSFI, shows a surplus in the plan on a solvency basis.**

It seems self evident that a policy on contribution holidays be included in any policy regarding funding. Having just recommended the development and communication of a Statement of Funding Policy, the inclusion of a policy on contribution holidays adds little if any cost but adds significantly to the information needed by plan members to assess their personal financial plans.

No contribution holiday should ever be permitted in circumstances where a solvency deficit might exist. Unless OSFI is satisfied a surplus does in fact exist no holiday should be allowed. This is a one of those common sense issues that warranted attention many years ago and was in fact recommended to OSFI by concerned Air Canada retirees prior to 2003/4.

Recommended: that 'contribution holidays' not be permitted to plan sponsors unless OSFI is satisfied that a solvency surplus currently exists in the pension plan sufficient to allow for the holiday

4. Issues for Discussion Pertaining to Defined Contribution Plans

My comments in response to this discussion paper are generally directed at defined benefit plans. Comments with regard to defined contribution plans are simply to highlight what I consider to be contrasts in regulation between DB and DC plans.

Some examples include:

A. Safe Harbour Protection for Qualified Default Investment Options

DC plan sponsors generally have no obligation to provide plan members with investment advice, nor any obligation to direct DC pension plan members to any particular investment option provided by an outside provider. The only impact of providing Safe Harbour

Protection to DC plan sponsors is to absolve them of any uncertainty that may exist as to their fiduciary responsibility to DC pension plan members. And without arguing the pros and cons of Safe Harbour protection for DC plans, it seems that once again the protection being offered is for the benefit of DC plan sponsors and not plan members. The incentive for sponsors to create let alone maintain DB plans will be further reduced by this 'improvement' for sponsors who offer DC plans.

B. Retirement Benefits Paid from the Pension Fund

For DB plan members this may be the most important area of difference between a DB plan and a DC plan when a plan sponsor becomes insolvent or voluntarily terminates a plan. And the easiest to fix for the benefit of DB plan members!

It is particularly interesting to note that DC plan members have the option to elect for either 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 a RIF, or alternatively another DB plan, but must accept an annuity 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 time. 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 may 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 provide.

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 continuation of DB plans where a fiduciary level of responsibility is the standard.

D. Use of Surplus in Defined Contribution Plan Components

No comment.

5. Other Issues Respecting the Framework for Private Pension Plans

E. Investment Rules

The surviving quantitative rules or limits clearly seem dated and should be significantly adjusted (probably downwards) in all instances. In any event one of the more important aspects of setting standards is to be able to adapt them to changing needs and circumstances. To carry on for fifteen or more years with the same ones seems hardly a reasonable thing to do.

THE END