

**RESPONSE BY THE CANADIAN LABOUR CONGRESS**

**to the**

**DEPARTMENT OF FINANCE CONSULTATION PAPER  
(JANUARY 2009)**

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



Canadian Labour Congress

Congrès du travail du Canada

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# **RESPONSE BY THE CANADIAN LABOUR CONGRESS**

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## **DEPARTMENT OF FINANCE CONSULTATION PAPER (JANUARY 2009)**

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

On behalf of the 3.2 million members of the Canadian Labour Congress (CLC), we want to thank you for affording us the opportunity to present our views. The CLC brings together Canada's national and international unions along with the provincial and territorial federations of labour and 130 district labour councils whose members work in virtually all sectors of the Canadian economy, in all occupations, in all parts of Canada.

### **INTRODUCTION**

The Canadian Labour Congress (CLC) thanks the Department of Finance for its public consultation on the federal legislative and regulatory framework for workplace pensions. The subject is important to the 3.2 million members of our Congress, and the \$300 billion they hold in workplace pension benefits.<sup>1</sup>

Having said that, our submission begins by emphasizing our concern with the limited scope of your consultation paper. In our view, a "fend for yourself" policy approach appears throughout the document, a perspective that has dominated thinking on pensions for far too long.

As we have described elsewhere, Canada pensions have historically been torn between two ideas: move forward together, or fend for yourself.<sup>2</sup> "Fend for yourself" advocates typically urge a limited, "minimum

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<sup>1</sup> We prefer the term "workplace pension" to other terms used to describe retirement benefits employees draw from employers. More commonly used terms ("private pension" or "registered pension plan"), in our view, do not reflect the fact that workplace pensions are largely negotiated by unions through a process of collective bargaining. The prevailing view that "private pensions" or "registered pension plans" are "voluntary" benefits offered through good will of employers conceals this fact.

<sup>2</sup> Canadian Labour Congress, *3<sup>rd</sup> CLC Pension Conference Discussion Paper* (2007), [www.canadianlabour.ca](http://www.canadianlabour.ca).

standards” role for pension rules, low benefits for public or mandatory pensions (e.g.: the Canada Pension Plan), and a “hands off” approach to regulating the individual savings products sold by banks and other financial companies (e.g.: Registered Retired Savings Plans, or Tax-Free Savings Accounts).

The three principles articulated early-on in your consultation paper bear close resemblance to this regrettable list of policy goals.<sup>3</sup> Your principles support a “voluntary” pension system where beneficiaries have “proper information” to make informed decisions in a legislative framework where “minimum standards are met”.

If your proposed minimum standards helped protect and improve workers’ pensions, we might be satisfied. Unfortunately, at a time when Canadians are looking for real pension leadership, for ideas to improve their retirement prospects, your consultation paper offers precious little.

Instead, as we will explain, you contemplate reforms that would pose serious risks and costs to workers’ pensions. While positive reforms are discussed, these are displaced by what is absent: policy options to meet the pension challenges working families and employers face today. You suggest little to build on the “move forward together” tradition in Canadian pensions, and the large-scale, stable, and secure retirement benefits that exist as a result (e.g.: large defined benefit plans, the CPP / QPP, and Old Age Security pensions).

With this in mind, our submission will comment on the questions raised in your consultation paper, but also transcend its limited framework. As such, some policy alternatives we propose involve changes to federal rules for workplace pensions, while others will require the federal government’s leadership in other areas.

In general, our submission is based on the belief that three important values should guide pension reform in the federal sector and elsewhere:

- Adequacy of pension income
- Security of pension benefits
- Fairness in pension outcomes

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<sup>3</sup> Department of Finance, *Strengthening the Legislative and Regulatory Framework for [Workplace Pensions] Subject to the Pension Benefits Standards Act, 1985* (January 2009), pp. 5-6.

These values, in our view, can offer major pension returns to working Canadians, the backbone of Canada's economy, at a time when such help is sorely needed.

Today employers and banks are receiving considerable help as the federal government navigates the global economic crisis. We think it is only fair that the pension needs of workers, those who make employer success possible, are also a top priority.

While we offer comments on all questions posed in your consultation paper, we want to highlight two CLC recommendations here for your attention:

1. Expanding the Canada Pension Plan (CPP)

As we will explain, an expanded CPP achieves two major objectives: it would offer efficient, secure and enhanced DB pension benefits to nearly all Canadians while also taking financial stress off workplace pensions (many of which are integrated with CPP benefits). This policy change would also provide real economic stimulus to the economy given spending patterns among retired Canadians;

2. A federal system of pension insurance

Canadians need a federal pension insurance system, comparable to what exists through the Canada Deposit Insurance Corporation for bank deposits, RRSPs and TFSAs. Such a system would be funded by contributions from federal workplace pension plan sponsors, administered by the federal government, and designed to ensure efficiency and fairness for all parties.<sup>4</sup>

We understand you initiated this consultation after having to introduce temporary solvency funding relief twice in the last four years. We are pleased to hear changes to federal workplace pension rules will be introduced by the end of 2009. As representatives of those fearful of losing their pensions, or other working Canadians without adequate pension coverage, we share your sense of urgency.

Once again, we appreciate the opportunity to share our views, and

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<sup>4</sup> This is the case in other pension jurisdictions (including Ontario) where oversight rules discourage fraudulent or frivolous claims, and where plan sponsors with a track record of well-funded workplace pensions pay less into pension insurance funds (relative to other plan sponsors with consistently bad funding). We continue this discussion on pp. 14-15.

welcome your interest to improve the federal legislative and regulatory framework for workplace pensions. We hope our submission will shift the limited and often concerning focus of your discussion paper. As we will explain, there is much to be done to improve pensions so Canadians can move forward together.

## **DEFINED BENEFIT PENSION ISSUES**

### **Why DB plans fit with our pension values**

As we have explained before,<sup>5</sup> defined benefit (or DB) pension plans are the preferred retirement option for workers given the pension values cited above in this submission:

#### 1. Adequate pension income

For different reasons, DB pensions are best-equipped among various workplace plans to offer adequate retirement income. In administrative terms, DB pensions have low administrative costs relative to more individualized plans. DB plans typically calculate one's pension income based on a "career average earnings" or "best final career average earnings" basis, which leads to more retirement income than could otherwise be expected from pensions geared to market returns and interest rates in a particular period.

#### 2. Security of pension benefits

Because workers are able to reasonably predict their future DB pension income, they are better equipped to make informed decisions about when they can or should retire.<sup>6</sup> DB pensions tend to be large in size, and therefore more capable to absorb the booms and busts of investment returns. In some provinces, workplace pensions are also covered by forms of pension insurance.

#### 3. Fairness in pension outcomes

DB pensions pool investment risk and life expectancy risk between different generations of workers, which leads to greater fairness in pension outcomes. Many DB pensions also offer partial or full protection

<sup>5</sup> See: Canadian Labour Congress, *Submission Brief to the Ontario Expert Commission on Pensions* (October 2007), [www.pensionreview.on.ca](http://www.pensionreview.on.ca).

<sup>6</sup> Most DB plans (career average or final average) take a certain number of years of a worker's salary to make this calculation, though some are structured differently. In any case, a worker can make a reasonable prediction about their expected retirement income.

against inflation, bridge benefits to accommodate earlier retirement plans, as well as flexibility for those who take time off work for child-rearing purposes.

The situation is quite different for individualized defined contribution (DC) plans, where one's pension income depends on the performance of pension investments and the prevailing interest rate when you retire. Pension income results for DC plans is particularly volatile during periods of economic turmoil.

To emphasize this, the following Table demonstrates what would happen to worker with a \$100,000 DC pension if they were invested in indexed Toronto Stock Exchange (TSX) assets. The Table calculates the value of the worker's \$100,000 DC pension at two periods in the current economic crisis: May 15, 2008 and February 15, 2009.

As the following Table makes plain, the difference in pension income is substantial (a 51% drop in value!):

**Table 1: Value of a \$100,000 DC plan at two moments of current economic crisis (TSX indexed funds)**

Date of retirement	Expected annual pension income
05/15/08	\$7,659.20 (or \$638.26 per month)
02/15/09	\$3,937.33 (or \$312.11 per month)

To briefly return to the issue of inflation, the Canadian Institute of Actuaries has demonstrated how even low inflation can dramatically change the value of one's pension over time. As the following Table shows, inflation protection remains a critical concern to ensure fair pension outcomes, and a main strength offered by several DB plans:

**Table 3: Impact of inflation on \$1000 in pension assets over time**

Number of years	After inflation				
	0.00%	1.00%	2.00%	3.00%	4.00%
1	\$1,000.00	\$990.00	\$980.00	\$970.00	\$962.00
10	\$1,000.00	\$905.00	\$820.00	\$739.00	\$676.00
20	\$1,000.00	\$820.00	\$673.00	\$545.00	\$456.00
30	\$1,000.00	\$742.00	\$552.00	\$402.00	\$308.00

Much has been written in recent months about the losses suffered by DB plans in the current economic crisis. There is no doubt that DB plans, particularly small DB plans, face significant funding challenges at the moment. This is likely why the federal Department of Finance (and several provinces) opted to provide temporary solvency funding relief for DB plans.<sup>7</sup>

Still, as we discuss in detail later, the funding challenges facing DB plans in today's economic crisis pale in comparison to the losses suffered by others with less secure pension coverage. As a pension expert from Watson Wyatt (a consultancy firm) commented recently: "While times are tough for DB plan sponsors at the moment, they are arguably even tougher for DC plan members."<sup>8</sup>

Now is not the time to entertain arguments about "abandoning DB pensions", or encouraging a "DC plan element" in the DB system. It is unfortunate that several of the options posed in your consultation paper give credence to these ideas. We know that employers are keen to make this shift, but they have done so (and will continue to do so) in the face of union opposition.

### **Current challenges for DB pensions**

As the Department of Finance considers how to address the challenges facing DB pensions, we advise you to remember the following points:

1. Solvency funding relief is an unsecured extension of credit from workers to employers

The CLC does not oppose temporary solvency funding relief provided plan sponsors get consent from the bargaining agent (the union) or a majority of pension plan beneficiaries (in a non-union workplace). In January 2009, the Department of Finance introduced a process for

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<sup>7</sup> For readers unfamiliar with this terminology, solvency funding for workplace pensions is a particular test to measure a plan's financial health. It assumes the workplace pension must pay out all liabilities at a given moment in time because the plan is being closed. Federal pension rules require solvency funding deficiencies to be corrected within five years. In essence, the solvency funding relief announced by the federal government lengthens this period to ten years provided certain criteria are met.

<sup>8</sup> See remarks by David Burke, Retirement Practice Coordinator for Watson Wyatt in "Double Vision: The DB Versus DC Debate", *Benefits Canada* (February 2009).

solvency funding relief that was similar to this, though with some concerning omissions.<sup>9</sup>

At the same time, most discussions of temporary solvency funding neglect to mention an important fact: that this process is in effect an unsecured transfer of credit from workers to an employer, one that poses major risks for the pension plan. A few words of explanation clarifies why this is so.

Today most employers are having major difficulties accessing credit for their daily and future operations. While the federal government has offered banks and other financial institutions new programs to expand access to credit, use of these programs has been limited.

Given these realities, it is likely employers will use any flexibility on pension funding to compensate for the financial crunch elsewhere in their operations. In the process, workers' pensions are financing the operations of their employer, and this happens without the protection normally afforded to secured creditors under federal bankruptcy law.

For this reason, we think it is only fair that the value of any solvency funding relief carry the legal weight of secured creditor status in corporate bankruptcies for pension plan members. As we have stated before, the CLC believes the full value of workers' pensions should have secured creditor status in corporate bankruptcy.<sup>10</sup> Affording this status to any solvency funding relief is only fair given the risks posed to workers and retirees in the process.

2. For most employers and plan sponsors, the pension cupboard isn't bare

A November 2008 report from Desjardins Securities argued most Canadian pension plan sponsors (unlike U.S. plan sponsors) can fund their pension plan shortfalls.<sup>11</sup> The report explained Canadian companies have operating profits 18.3 times their pension liabilities, and

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<sup>9</sup> The Office of the Superintendent of Financial Institutions (OSFI), the federal government's regulator for workplace pensions, has announced recently that pension plan sponsors for a short period are able to access solvency funding relief without following this process, and that the process doesn't apply to crown corporations. The CLC considers this a major error to be corrected at once.

<sup>10</sup> Canadian Labour Congress, *Submission to the Senate Committee on Banking, Trade and Commerce Regarding Bill C-12* (November 28, 2007), [www.canadianlabour.ca](http://www.canadianlabour.ca).

<sup>11</sup> Peter Gibson, Ed Sollbach and Jeff Evans (Desjardins Securities), *Research Comment: Could a Pension Crisis be Next? An Analysis of Pension Shortfalls in Canada and the US* (November 11, 2008).

an average firm could pay down their pension liabilities with just one to two months of profit, or a year's worth of operating cash flow.

This is so because Canadian employers have largely hoarded market windfalls in recent years as cash. The *Canadian Economic Observer* noted two years ago that non-financial employers had a surplus of \$80.2 billion on their balance sheets, and explained this trend as a consequence of employers seeking to maximize returns in financial investments.<sup>12</sup>

### 3. Yesterday's contribution holidays have come home to roost

As we have explained elsewhere,<sup>13</sup> during the 1980s and 1990s, many employers thought pension plans would pay for themselves through investment returns. Because of this, contribution holidays were common.

This led to a "no-cost" pension funding approach which was in full stride by the 1990s technology stocks boom, when ballooning pension assets put some into fits of delirium. During these years, despite global market trouble in 1987 and 1997-1998, few felt a cautious pension funding approach was necessary. Contribution holidays continued in earnest. Favourable economic trends made pension liabilities seem manageable.

The Régie des Rentes, Quebec's pension regulator, estimates that \$2.9 billion in contribution holidays were taken in Quebec from 1991 to 2000.<sup>14</sup> Other studies have identified comparable trends during this period in the rest of Canada.<sup>15</sup>

In many cases, today's pension shortfalls are yesterday's contribution holidays coming home to roost. They are the result of pension funding rules that allow plan sponsors to avoid doing what average Canadians do when a financial windfall arrives: put money aside today for expenses to come tomorrow.

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<sup>12</sup> Statistics Canada, "Recent Trends in Corporate Finance" *Canadian Economic Observer* (April 2006). For an international perspective, see: Roberto Cardarelli et al., "Awash With Cash: Why are Corporate Savings so High?", *IMF World Economic Outlook* (April 2006).

<sup>13</sup> Canadian Labour Congress, *3<sup>rd</sup> CLC Pension Conference Discussion Paper* (2007), [www.canadianlabour.ca](http://www.canadianlabour.ca).

<sup>14</sup> See: Murray Gold, "Current Pension Issues and Trends", *Koskie Minsky LLP* (2006), pp. 11-12.

<sup>15</sup> Statistics Canada, "Trusteed Pension Funds: Income, Expenditures, and Assets", *Canada's Retirement Income Programs* (2006). Gil Yaron, "Taking a Holiday: The Impact of Employer Contribution Holidays on the Funding of Defined Benefit Pension Plans" (Shareholder Association for Research and Education: 2005).

Annex 2 to this submission documents how this didn't happen at Canada Post Corporation. Canada Post Management took advantage of solvency funding relief in 2006, but began to enter into surpluses later in 2007 given a rebound in capital markets. In 2007, pursuant to negotiations, CPC began taking contribution holidays to avoid holding more than 10% surplus in their pension plan (as per Revenue Canada rules). Unfortunately, they continued to do so until October 2008, long after news of the current financial crisis was clear. The end result of this process is a current \$2.3 billion shortfall in the Canada Post's pension plan on a solvency basis.

In light of all of above, policy measures to restrict the use of contribution holidays – and encourage the surplus being accrued in pensions workplace to cope with market downturns – are welcome.

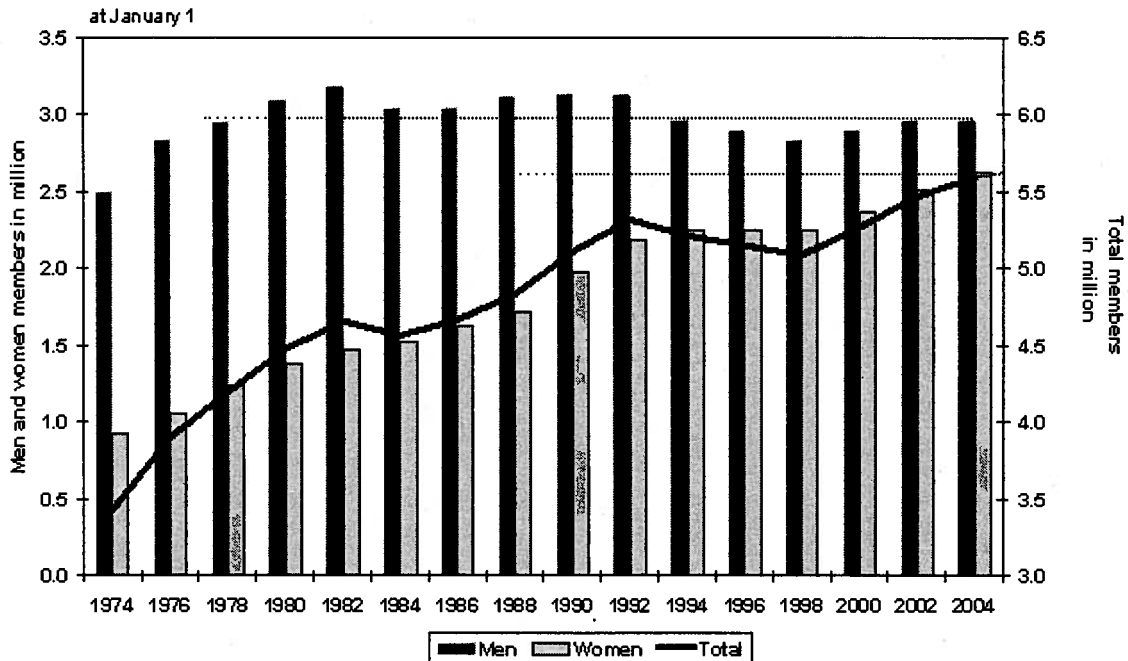
A key reform within the federal government's power would involve raising the threshold in the *Income Tax Act* preventing DB pensions from accumulating a surplus in excess of 10% of assets. A target of 20% above assets would allow for the creation of significant reserves to address market downturns.

4. DB coverage has expanded for some (thanks to effective pension planning)

For good reason, much pension discussion has focused on the diminishing DB coverage rates, particularly in the private sector. This remains a major problem that we think is best addressed through an expansion of the CPP and increases to public pension income. At the same time, DB coverage has improved in recent decades for unions who have made it a priority in collective bargaining.

As the following Chart explains, the number of women in workplace pension plans tripled from 1974 to 2004. During this period, almost all the increase in workplace pension plan membership came from women joining unions, and gaining DB pension coverage as a result.

**Chart 1. An increase in female membership was the major factor in total membership growth, substantially reducing the gap between the sexes**



Source: Statistics Canada, Pension Plans in Canada Survey.

Some think this highlights a trend of unfair treatment between public sector and private sector workers. Why should the taxpaying public, the argument goes, many of whom have insecure pension coverage, finance DB pensions for public sector workers? Why should pension outcomes for public sector and private sector workers be vastly different?

We urge you to reject this argument. As the CLC has explained before,<sup>16</sup> there are three major flaws in its reasoning.

First, most private sector employers have not fulfilled their promise to introduce decent workplace pensions, and this is no fault of public sector workers. In recent decades, in pension review after pension review, representatives for private sector employers have pledged to introduce decent pensions, but demanded that happen on a voluntary basis.

Such claims attempted to thwart any expansion of the CPP, public pensions, or the creation of a mandatory pension scheme. This was justified on the basis of minimizing “government intrusion” in the private sector, while encouraging workplace coverage through proper “incentives”. The abysmal results of this strategy are now clear.

<sup>16</sup> See “Georgetti on pensions: ‘The CFIB’s Thinking us Upside Down’” (January 23, 2007), [www.canadianlabour.ca](http://www.canadianlabour.ca).

Secondly, most workers in the public sector have DB pensions because they were prioritized in decades of collective bargaining negotiations, often at the expense of wage increases or other improvements. Public sector DB pensions are therefore best understood as deferred wages, and the positive result of sound pension planning.

Thirdly, it is not accurate to claim that public sector DB plans are entirely financed by government revenues. Most public sector DB plans (particularly large plans) are financed by joint contributions from employers and workers. As a consequence, many large public sector DB plans have seen contribution rate increases from employers and workers to compensate for losses suffered in recent market downturns.

The critics of public sector DB pensions should take a few lessons in effective pension planning from public sector unions. Instead of urging government employers to diminish pension coverage, we need reforms to expand decent DB pension coverage to all Canadians. The next point we discuss, in our view, offers the best strategy for that to happen.

#### 5. Improving the Canada Pension Plan: the best way to expand the federal DB pension system

As several researchers have raised, an important means to extend decent pension coverage involves expanding benefits for the CPP. CPP benefits are calculated on a DB basis, offering workers an accurate sense of expected pension income on retirement. The CPP covers the vast majority of working Canadians (93%), and has a benefit design most workplace plans can't match.

CPP benefits are indexed to inflation and portable across jobs. CPP benefits are available to same-sex couples, and sensitive to the needs of those who take time off work to raise children. The CPP's Chief Actuary also confirms the plan is financially sound until long after the "baby boom" retirement wave will end (2085).

The problem with the CPP (like the Old Age Security program) is its modest benefits. From its inception in 1966, the CPP was targeted to replace no more than 25% of the average industrial wage. In 2009, the maximum monthly benefit for individuals at age 65 was \$908.75, though many do not qualify for this amount.<sup>17</sup>

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<sup>17</sup> Service Canada, "Income Security Programs Rate Card" (January – March 2009).

Also, because CPP benefits are solely based on contributions, equality-seeking Canadians (women, recent immigrants, workers of colour, First Nations, people with disabilities) fare worse given lower earnings, their predominance in part-time jobs, and the time off many seek for family care responsibilities beyond child-rearing (elder care, family tragedies, etc).

Though the CPP is an employer-worker funded benefit, it is governed by the Finance Ministers of federal and provincial governments. The federal government also plays a role in designing the plan's administrative framework and operating policy. Since 1997, CPP assets have been invested by an arms-length body (the Canada Pension Plan Investment Board) and, also as of 1997, any benefit level changes require proposals to fund them in advance.

Given all that has recently happened to Canadian pensions, and given 2009 is the year the CPP is being reviewed, it is time for the federal government to demonstrate leadership in the area of CPP reform. We support a substantial increase to Old Age Security benefits for similar reasons.

We therefore reiterate the CLC's proposal to enhance CPP and OAS benefits we have articulated in previous documents:

- **CPP policy goal:** to increase the replacement rate for CPP retirement pensions going forward from 25% to 50% of the average industrial wage.

We propose you finance this policy goal through the following actions with provincial Finance Ministers:

- i) An increase to the yearly maximum pensionable earnings (YMPE) threshold for CPP contributions (currently \$46,300);
- ii) An increase in CPP contributions (phased in, like the 1997 CPP reforms, over a period of seven years).

- **OAS policy goal:** a 15% increase to OAS benefits to lift all seniors over the low-income cut-off line established by Statistics Canada.

We propose you finance this policy goal through the following actions:

- i) An additional yearly allocation of \$1.2 billion in federal spending for OAS benefits;

- ii) Rescind the personal tax cuts announced in the 2009 Federal Budget to finance this benefit improvement (a savings of \$1.885 billion in 2009-2010 alone).<sup>18</sup>

## 6. The case for federal pension insurance

Beyond the losses suffered in pension assets, the current economic crisis has also exposed the insecurity for workers' pensions in general.

Alarming job losses in Canada's manufacturing and forestry sector (320,000 since 2002, with 400,000 expected for 2009 alone) have arrived with a sharp rise in employer bankruptcies. The federal government is currently stumbling through this crisis with no overall plan to protect Canadian jobs, and the promised pension benefits that often come with them.

Now more than ever, Canadians need a federal system of pension insurance to protect what they have earned. Such protection already exists through the Canada Deposit Insurance Corporation for bank deposits, RRSPs, and TFSAs.

Recently, Quebec announced policy measures to protect abandoned pensions, and the Ontario Expert Commission on Pensions recommended a substantial increase to the pension insurance system that exists in that province. Annex 2 to this submission details the models of pension insurance that exist elsewhere.

Critics of pension insurance systems tend to claim such programs help "bad employers" offload pension costs (at the expense of good employers). This argument, however, ignores the fact that pension insurance is required for reasons outside any employer's control. To cite a useful metaphor, it is like saying seat belts help bad drivers at the expense of the law-abiding public.

In the real world, accidents happen, and often for reasons beyond any the activities of one person in particular. Highway accidents can be caused by bad drivers, but they also come from unpredictable and unfortunate incidents (e.g.: poor driving conditions). For that reason,

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<sup>18</sup> As the Canadian Centre for Policy Alternatives has raised, these tax cuts amount to \$33 per year for low income Canadians, and \$300 per year for moderate and middle-income Canadians. Financing an improvement to OAS benefits, the CCPA notes, would achieve better social and economic results (given fixed income pensioners are more likely to spend extra dollars on essentials, thereby providing immediate stimulus to Canada's economy. See: CCPA, *Beyond the Crisis: 2009 Alternative Federal Budget* (February 2009), [www.policyalternatives.ca](http://www.policyalternatives.ca). For personal tax cut estimates, see: Government of Canada, *Canada's Economic Action Plan* (February 2009), p.254.

Canadian law requires all drivers to carry insurance coverage for their vehicles.

The same should be true for workplace pensions. The booms and busts of global capitalism mean some employers will fall on hard times, and often for factors outside their control.

Because of this, the federal government should create an employer-funded national system of pension insurance modelled on the framework that exists in Ontario. Measures to protect against fraudulent claims can be integrated into this system.<sup>19</sup>

### **Responses to questions raised in your consultation paper (DB pensions)**

#### 1) Solvency measurement and funding rules

As indicated above, the CLC supports a solvency test to determine the funding health of DB pensions. We are opposed to permanent changes to relax solvency funding rules, given this is, in effect, an unsecured transfer of credit from pension plan members and beneficiaries to plan sponsors.

We are agreeable to temporary solvency funding relief for plan sponsors in significant trouble on a case-by-case basis, provided the sponsor gains the consent of the bargaining agent (union) or a majority of beneficiaries (in a non-union workplace). Effective immediately, we call on the federal government to ensure this requirement is followed for crown corporations, and for every application for solvency funding relief in 2009.

We see no reason to revise or tier solvency tests to suit the “financial health” of plan sponsors as this would be rewarding plan sponsors for simply observing their obligation to properly fund pension plans.

While letters of credit have been introduced in several Canadian pension jurisdictions, we are concerned that plan sponsors in greatest financial need will not receive them in current economic conditions.

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<sup>19</sup> See discussion of pension insurance systems in: Government of Ontario, *A Fine Balance: Safe Pensions – Affordable Plans – Fair Rules, Report of the Expert Commission on Pensions* (2008), [www.pensionreview.on.ca](http://www.pensionreview.on.ca).

For that reason we call on the federal government to offer pension plans credit assistance through its recently-created Extraordinary Financing Framework in the 2009 Federal Budget. Such government-sanctioned assistance would offer workers and their families more security in their protection of their pension benefits.

2) Requiring full funding on voluntary plan termination

Given there is currently a broad employer-union consensus that this change be implemented, the CLC urges this happens right away.<sup>20</sup> There is no justifiable reason why federal sector plan sponsors should be able to close pension plans with no responsibility to ensure they are fully-funded.

3) Partial termination and immediate vesting

We think it is important to separate these two issues. The CLC supports immediate vesting rights which would ensure workers get the full benefit of pension contributions invested and/or earned.

We also support maintaining partial termination rules given there are circumstances where this process is necessary. If anything, we think partial termination rules should be changed to account for the particular needs of multi-employer plans.

4) Disclosure of information

The CLC supports more disclosure of information to pension plan members. This is particularly true for information that assists workers, retirees, and other beneficiaries in determining the security and funding health of their pension plan.

We recommend that pension funds be required to disclose the extent to which, if at all, environmental, social and corporate governance (ESG) considerations are taken into account in the selection, retention and realization of investments, and in the exercise of proxy voting rights. This kind of disclosure would enhance the security of pension investments and strengthen pension plan accountability and transparency. Mandating such disclosure helps clarify the potential materiality of ESG issues for fiduciaries and also encourages pension fund investment managers and other capital market agents to improve investment practices

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<sup>20</sup> The Association for Canadian Pension Management has supported this proposal. See: ACPM, *Back From the Brink: Securing the Future of Defined Benefit Pension Plans* (August 2005), p. 24.

by integrating ESG factors into their investment analysis.<sup>21</sup>

We further support the notion of a mandatory funding policy for plan sponsors, a summary of which should be made available in annual pension statements to plan members. Such a statement should include the plan sponsor's use of any contribution holidays taken in a given year.

#### 5) Contribution holidays

We believe it is time for federal pension rules to lead in restricting the use of contribution holidays, and clearly reporting to plan members when a contribution holiday takes place. The measures you suggest improve upon current rules, but do not go far enough.

In our view, it is the responsibility of the plan actuary to certify when a contribution holiday is requested by the plan sponsor and to specify the reasons for the request. This request should be reported to the bargaining agent (the union) for approval to ensure a contribution holiday is in fact appropriate.

As a rule, the CLC thinks contribution holidays detract from a plan sponsor's ability to create a reserve fund to address market downturns. We are therefore inclined to support policy measures that restrict their use as much as possible.

#### 6) Void amendments

The CLC is opposed to this policy change as it would be overly restrictive. The proposal as written is too broad and sweeping in its implications. The 85% solvency funding rate is so high as to make too many amendments subject to being voided. We also oppose this plan in general because it would effectively undo the results of collective bargaining in certain cases. Further, employers who entered into bargaining with a poorly funded pension, deliberately or not, would in effect escape having to negotiate pension improvements. The union does not believe that regulations that

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<sup>21</sup> Specifically, we recommend Section 7.1(1) of the *PBSA* be amended to require federally registered pension funds to disclose the extent (if at all) to which environmental, social and governance considerations are taken into account in proxy voting activities, and the selection, retention and management of investments; and require pension funds to annually disclose their proxy voting guidelines and voting records.

threaten the power of collective bargaining are a productive way to regulate the sponsor's funding of obligations to its members.

## **DEFINED CONTRIBUTION PENSION ISSUES**

### **Why DC plans conflict with our pension values**

Defined contribution (or DC) plans pose several challenges in providing a suitable retirement for workers. Unions with DC plans try their best to deliver good returns to their members, but face serious constraints in doing so. Given their design and allocation of risks, DC plans conflict with our pension values cited in this submission:

#### 1. Adequate pension income

Several factors prevent DC plans from being an adequate and reliable source of pension income.

Because of their individualized plan design, DC plans are often complex and expensive to run. It is common for DC plans to have administration charges (so-called "Management Expense Ratios", or MERs) that bleed 20% to 40% of a workers retirement income over an average working life. MERs for group or individual RRSPs are often even worse.

Based on conservative assumptions, Annex 3 to this submission details what a 3% MER would cost a worker's DC plan or RRSP over forty years (a loss of 40% in pension income). As even pension industry commentators point out, the excessive fees charged by DC and group RRSP money managers are indefensible.

Even worse, through its substantial tax subsidies to DC plans and RRSPs, the federal and provincial governments are re-directing tax dollars into the soaring fees charged by financial industry elites. This is a classic case of reverse-Robin-Hood, where the retirement incomes of regular Canadians get re-directed to the overpaid elites of Bay Street.

Further complicating matters for workers with DC plans is the responsibility to choose an investment strategy (usually from a range of options provided by the plan sponsor). Most people – like most professional money managers<sup>22</sup> – are unable to consistently generate above-average pension investment returns, leading to serious consequences for future pension income.

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<sup>22</sup> See: John Heinzl "Volatile TSX Still Beat Investment Pros", *The Globe and Mail* (July 5, 2008).

## 2. Security of pension benefits

As stated above, the value of a worker's DC pension can fluctuate wildly depending on two things: a) the performance of investment returns, and b) the prevailing interest rate when a DC plan is transferred at retirement into an annuity or fund to pay out a worker's pension.

This uncertainty stems from the fact that workers bear investment and interest rate risk in a DC plan, unlike a DB plan where that risk falls on the plan sponsor. This allocation of risk in DC plans leads to less security for workers' pension benefits.

The sole pension security advantage of DC plans is their easy portability when workers change jobs, something very significant given the realities of modern labour markets. The only DB plans that offer a similar degree of portability are the Canada and Quebec Pension Plans. This is an important reason motivating our support for significant expansion of CPP/QPP benefits.

## 3. Fairness in pension outcomes

We have already discussed the pension security problems for workers with DC plans during periods of stock market volatility. Benefit reductions of nearly 40% during the latest economic crisis demonstrate how ill-equipped DC plans are to absorb the booms and busts of global capitalism.

This alone should caution policymakers against introducing DC plans as a means to address the widespread lack of pension security. Nevertheless, the provinces of British Columbia, Alberta, and Nova Scotia are now encouraging different models of province-wide DC plans.

To promote fair pension outcomes, we should ask these questions:

- Should a dignified retirement be based on good luck in playing the markets and fortunate timing as to when one chooses to retire? How does this promote fair and balanced pension outcomes?
- Why should a huge chunk of one's pension get absorbed by inflated management fees?
- In a country as wealthy as Canada, is this the best pension security governments can offer after a lifetime of hard work?

## **Responses to questions raised in your discussion paper (DC Pensions)**

### 1. Safe harbour protection for qualified default investment options

This proposal, in our view, would allow DC plan sponsors to insulate themselves from legal accountability for providing sound investment choices for plan members.

DC plan sponsors must exercise caution and due diligence when they provide investment advice, and this is particularly true for default investment options which studies indicate most members select. If a DC plan sponsor is imprudent in their selection of default investment options for plan members, they expose themselves, for good reason, to legal action.

Allowing plan sponsors a “free pass” in these duties would constitute an accountability breach in the federal workplace pension system, one the labour movement would oppose by all means necessary.

Furthermore, we find it ironic that pro-employer lobby groups supporting this proposal are the same voices consistently opposing DB plans. On the one hand, they dismiss DB plans as “risky endeavours”, but, on the other hand, they seek to absolve DC plan sponsors from legal accountability, and shift risk to workers and retirees.

### 2. Retirement benefits paid from the pension fund

The CLC supports this policy measure provided the costs and responsibilities associated with it are made clear to plan sponsors and plan members. It is likely that only large DC plan sponsors would be capable of self-annuitizing retirement benefits in this way. Still, this could lead to better pension income for plan members if plan sponsors were able to offer more efficient returns than what is currently available from the commercial annuities market.

### 3. Standard of care changes

The CLC strongly opposes this proposal as it would dilute the accountability of DC plan sponsors to plan members. Given all we have seen in the current economic crisis, and its disproportionate

impact on DC plans, now is not the time for weaker pension rules. If anything, changes to pension legislation should place a fiduciary duty on not only DC plan sponsors but key service providers to DC plans (actuaries, auditors, custodians, etc). The CLC supports similar clarification to key service providers for DB plans.

#### 4. Use of surplus in defined contribution plan components

This proposal is a political and legal non-starter. The labour movement has made clear its opinion on the ownership of pension surplus in successive legal proceedings. We see no reason to change our position, particularly given a lack of pension insurance or needed safeguards for workers' pensions in bankruptcy law.

Any surplus from a DB plan should ideally be set aside in a reserve fund to accommodate market downturns in the future. Expanding the amount of surplus a plan sponsor can accrue under the *Income Tax Act* would facilitate this prudent use of DB plan surplus. Using DB plan surplus to finance DC plans is an inappropriate use of plan assets.

#### 5. Administrative procedures

While we recognize there are additional costs associated with accounting for deferred vested plan members, we fear this proposal will result in poor outcomes for workers and their families. In general, allowing greater unlocking or access to one's pension assets undermines the purpose of having a pension at all.

A benign paternalism exists in Canadian pension legislation, where plan members (even deferred vested plan members) benefit from being prevented from accessing their retirement income until they retire.

Studies also suggest that deferred vested plan members are best off leaving their pension assets in workplace plans rather than transferring them to more expensive options available on the retail market. Exceptions can be made in cases of financial hardship, but the parameters involved should be narrowly-defined and not open to widespread use.

## OTHER ISSUES

### Responses to questions raised in your consultation paper

1. Flexibility of the *Pensions Benefits Standards Act*, 1985 (for new kinds of pension plans), Simplified Pension Plans.

The CLC is not inclined to endorse new kinds of pension plans as a solution to the crisis of decent pension coverage among working Canadians. We prefer to improve on the “three pillars” of Canada’s retirement income system cited in your consultation paper. We think there is ample room within this system to create adequate pension incomes, improve the security of pension benefits, and ensure the fairness of pension outcomes.

For us, that involves changes to encourage large-scale DB plans, and expanded benefits for CPP and OAS. Creating new species of pension plans (or channelling resources into “Simplified Pension Plans”) distracts attention from focused efforts to improve what works in Canada’s existing retirement income system.

2. Multi-Employer Pension Plans

We do not see the need for government assistance to improve the fortunes of Multi-Employer Pension Plans (or MEPPs). Indeed, the labour movement itself has the capacity to extend DB (or flat-benefit DB) membership in MEPPs, something that is happening in several small but growing plans outside the federal sector.<sup>23</sup>

Once again, we prefer the federal government to focus policy changes in areas within its immediate control: creating a national system of pension insurance, and expanding benefits for the CPP and OAS. Changes in these successful, large-scale areas of pension income can produce the best possible results.

3. Distinction between DC and DB plans under the *PBSA*

The CLC supports changes to the *PBSA* which would introduce more stringent rules for DC plans, and laments the fact that DC regulations in many areas remain unclear.

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<sup>23</sup> The Multi-Sector Pension Plan and Nursing Homes and Related Industries Pension Plan are good examples. For more information about these plans, see: [www.mspp.ca](http://www.mspp.ca), [www.nursinghomepension.com](http://www.nursinghomepension.com).

At the same time, we insist that any changes to the *PBSA* should not involve any diminished standard of care for DB plans.

#### 4. Investment rules

The CLC does not have any firm views on the investment rules cited in your discussion paper. Having said that, we are intrigued by examples in Quebec where pension funds have been an important source of capital for regional development. We encourage the federal government to consider legislation that could allow for this to happen for pensions under its jurisdiction.

On a related subject, however, we urge you to consider how responsible investment practices by pension fiduciaries can be an important source of positive change. There is a growing consensus in the investment community that environmental, social and governance (ESG) factors are an important component of risk management and a potential source of value creation over the long-term.

In spite of the evidence that ESG factors can have a material and positive impact on investment performance, fiduciaries are reluctant to incorporate these criteria into their investment decisions because they fear that doing so will constitute a breach of their statutory or common law duties to plan beneficiaries. Specific clarification that pension plan trustees may consider environmental, social and governance factors in their investment decisions is needed.<sup>24</sup>

This document is respectfully submitted on behalf of the Canadian Labour Congress:



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Kenneth V. Georgetti, President

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<sup>24</sup> Specifically, we ask the federal government to clarify that the standard of care governing pension plan trustees under the Pension Benefits Standards Act, 1985 (the Act) does not preclude trustees from considering environmental, social and governance criteria as part of the investment decision-making process provided that such considerations are made in the overall context of fiduciary responsibility and the tests of prudence otherwise applicable to trustees.

Table 1: Major Pension Insurance Programs

Country (programme)	Who is covered	Coverage amount	Premium/ Cost Structure	Claim process	System status
US (Pension Benefit Guarantee Corporation)	Participants in private DB plans.	Vested benefits up to a \$44,300 maximum.	Charge based on number of participants and underfunded amount.	Assets and liabilities taken over in case of corporate bankruptcy.	Surplus of \$7.7bn in 2001 eroded to a deficit of \$23.3bn 2004.
Canada - Ontario (Pension Benefit Guarantee Fund)	Participants in private DB plans.	Vested benefits up to CAD 12,000 (US \$10,000) annual maximum.	Charge based on number of participants and underfunded amount.	Cash allocation made to plan administrator to cover guaranteed benefits.	CAD \$100m deficit (US \$84M), with several further large potential claims pending.
UK (Pension Protection Fund)	Participants in eligible DB plans (this will include some public sector schemes that do not have a full crown guarantee).	Pensioners, survivor and ill health pension at 100% (subject to a review of the rules of the scheme), with increases in accordance with PPF rules. Under pensionable age, 90% capped (estimated GBP 25,000 US \$46,000) - again increases subject to PPF rules.	Administration and fraud compensation flat based levies. To fund compensation payments: an initial levy (in year 1) and then a scheme based and a risk based levy. Ultimately the risk based levy must collect at least 80% of the total.	Assets and liabilities taken over in case of corporate bankruptcy.	PPF proposed to be in place from April 2005. Government estimates GBP 300m (US \$550m) annual funding to be raised.
Germany (Pensions-Sicherungs-Verein)	Participants in book reserve, support fund or pensionsfonds financed plans.	Statutory vested benefits up to €86,700 (US \$112,000) annual maximum.	Charge is a % of liabilities, and reflects experience in prior year.	Insolvency of a member company triggers annuity purchase.	Ex post premium ensures ongoing solvency of PSV.
Sweden (Forsakringsbolaget Pensionsgaranti)	Contractual coverage of white collar employees.	Full benefits.	Charge is % of liabilities; collateral required if insolvency risk deemed high.	Insolvency of a member company triggers annuity purchase.	End of 2003 reserves of \$1.7bn and potential insurance exposure of \$15bn.
Switzerland (sicherheitsfonds BVG)	Participants in DB and Swiss-style DC schemes.	100% of government-mandated minimum benefits; Additional benefits are subject to salary cap.	Charged based on liabilities.	When pension plan declared insolvent, annuities are purchased.	Reserves of CHF 300m (\$217m) in early 1990's have eroded to CHF19m (\$14m).
Japan (Pension Guarantee Programme)	Members of EPF.	0.3x substitutional component and half of any benefits in excess of this amount.	Premiums related to size of company, size of benefit and risk adjusted for level of underfunding.	Unclear what events trigger a claim.	Reserves of Y30bn (US \$285m).

## **ANNEX 2: CANADA POST'S USE OF SOLVENCY FUNDING RELIEF**

Over the period from 2002 to 2005, the Canada Post Corporation Pension Plan experienced significant solvency deficiencies which required additional special payments on behalf of the plan sponsor as per the provisions of the federal *Pension Benefits Standards Act (PBSA)*. These solvency deficiency payments were funded through a combination of: 1) direct additional employer contributions totaling \$669 million over the period from 2003 to 2006 plus 2) transfers of a total of \$159 million over the from 2004 to 2006 from the funding excesses reported in the annual Canada Post Corporation Supplementary Retirement Arrangement (SRA) actuarial valuations. This latter arrangement was permitted by virtue of an amendment to the SRA approved by the Board of Directors of Canada Post Corporation (i.e. the plan sponsor) in 2004 allowing the withdrawal of all or any part of excess assets identified in the previous year's actuarial valuation of the SRA to be used to meet the funding obligations of Canada Post Corporation to the Canada Post Corporation Registered Pension Plan.

The federal budget speech of May 2<sup>nd</sup>, 2006 contained the announcement of the Federal Government's intention to introduce temporary solvency funding relief measures for federally regulated defined benefit pension plans. On November 7<sup>th</sup>, 2006, the Federal Minister of Finance released the final pension solvency funding relief regulations which allowed federal Crown Corporations such as Canada Post Corporation, a one-time opportunity to extend the solvency funding amortization period from 5 to 10 years for any solvency deficiency revealed in an actuarial valuation filed subsequent to December 30<sup>th</sup>, 2005. Unlike other federally-regulated pension plan sponsors, proposals for solvency funding relief measures from federal Crown Corporations were not to be subject to the approval of a prescribed threshold of plan participants and beneficiaries.

In January, 2007, the Board of Directors of Canada Post Corporation approved the pursuit of retroactive application of solvency funding relief measures by re-filing an amended actuarial valuation report as of December 31<sup>st</sup>, 2005 with the Office of the Superintendent of Financial Institutions (OSFI) and the Canada Revenue Agency (CRA). As a consequence of the foregoing, the annual pension solvency deficiency payments required by Canada Post Corporation for 2006 were reduced from \$316 million to \$150 million. As Canada Post Corporation had already remitted \$288 million towards the solvency deficiency amortization payments during the initial 3 quarters of 2006, there was

no requirement for payment of the final quarterly installment (due at the end of January, 2007).

For purposes of clarification the table below, which illustrates the amounts and sources of funding the pension solvency deficiency amortization payments of Canada Post Corporation over the period from 2003 to 2006, has been prepared.

**TABLE 1**  
**Solvency Deficiency Payments to Canada Post Corporation**  
**Registered Pension Plan**  
(\$ Millions)

Year	2003	2004	2005	2006	2003-2006
<b>Regular</b>	109	51	270	239	669
<b>Transfer from SRA</b>		78	32	49	159
<b>TOTAL</b>	109	129	302	288	828

It should be noted that during the years requiring special solvency deficiency payments, Canada Post Corporation spared no opportunity to remind bargaining agents of these additional financial commitments required in accordance with the federal *PBSA*. This was particularly the case during contract negotiations for the renewal of collective agreements.

The actuarial valuation conducted as of December 31<sup>st</sup>, 2006 revealed the Canada Post Corporation Registered Pension Plan was in a surplus position on a solvency basis of \$283 million and on a going concern basis of \$993 million. Employer representatives of the Canada Post Corporation Pension Plan attributed the significant turnaround in solvency status to a number of developments including improved investment performance, lower interest rates (decreasing pension plan liabilities), as well as the additional special payments contributed by Canada Post Corporation over the period from 2003 to 2006.

In a written communication to all plan members dated August 2<sup>nd</sup>, 2007, Canada Post Corporation President and Chief Executive Officer, Ms. Moya Greene, announced that, based on the fully funded status of the Canada Post Corporation Pension Plan, regular employer pension contributions would not be required through to the remainder of 2007. Ms. Greene also attempted to reassure Canada Post Corporation Pension Plan participants that the decision to pursue an employer contribution holiday “... will in no way impact the overall financial strength of the Plan”. This initiative was never discussed beforehand with any of the bargaining agent representatives at the Canada Post Corporation Pension Advisory Council.

Within days of Ms. Greene's announcement, global capital markets experienced significant volatility arising from concerns over financial implications associated with sub-prime mortgages in the U.S. and the lowering of interest rates by the U.S. Federal Reserve Board. Canada Post Corporation bargaining agents continued to raise concerns regarding the uncertain long-term economic outlook and the potential implications for pension funding. Nonetheless, Canada Post Corporation maintained the employer contribution holiday throughout the economic and financial turmoil experienced during the first 10 months of 2008. It was only in November of 2008, that Canada Post Corporation resumed employer pension contributions and only after persistent objections of the bargaining agents represented on the Canada Post Corporation Pension Advisory Council.

In the latest financial information presented to the Canada Post Corporation Pension Advisory Council in February of 2009, it appears that the Canada Post Corporation Registered Pension Plan is currently experiencing an estimated solvency deficiency of approximately \$2.3 billion.

### ANNEX 3: THE COST OF TYPICAL RRSP FEES

Investment Return	0.05
MER	0.03
Contribution	5000

Year	Inflow	Operating Balance	Interest	MER	Closing Balance
1	5000	0.00	0.00	0.00	5000.00
2	5000	5000.00	250.00	125.00	10125.00
3	5000	10125.00	506.25	253.13	15378.13
4	5000	15378.13	768.91	384.45	20762.58
5	5000	20762.58	1038.13	519.06	26281.64
6	5000	26281.64	1314.08	657.04	31938.68
7	5000	31938.68	1596.93	798.47	37737.15
8	5000	37737.15	1886.86	943.43	43680.58
9	5000	43680.58	2184.03	1092.01	49772.59
10	5000	49772.59	2488.63	1244.31	56016.91
11	5000	56016.91	2800.85	1400.42	62417.33
12	5000	62417.33	3120.87	1560.43	68977.76
13	5000	68977.76	3448.89	1724.44	75702.21
14	5000	75702.21	3785.11	1892.56	82594.76
15	5000	82594.76	4129.74	2064.87	89659.63
16	5000	89659.63	4482.98	2241.49	96901.12
17	5000	96901.12	4845.06	2422.53	104323.65
18	5000	104323.65	5216.18	2608.09	111931.74
19	5000	111931.74	5596.59	2798.29	119730.04
20	5000	119730.04	5986.50	2993.25	127723.29
21	5000	127723.29	6386.16	3193.08	135916.37
22	5000	135916.37	6795.82	3397.91	144314.28
23	5000	144314.28	7215.71	3607.86	152922.14
24	5000	152922.14	7646.11	3823.05	161745.19
25	5000	161745.19	8087.26	4043.63	170788.82
26	5000	170788.82	8539.44	4269.72	180058.54
27	5000	180058.54	9002.93	4501.46	189560.00
28	5000	189560.00	9478.00	4739.00	199299.00
29	5000	199299.00	9964.95	4982.48	209281.48
30	5000	209281.48	10464.07	5232.04	219513.52
31	5000	219513.52	10975.68	5487.84	230001.35
32	5000	230001.35	11500.07	5750.03	240751.39
33	5000	240751.39	12037.57	6018.78	251770.17
34	5000	251770.17	12588.51	6294.25	263064.43
35	5000	263064.43	13153.22	6576.61	274641.04
36	5000	274641.04	13732.05	6866.03	286507.06
37	5000	286507.06	14325.35	7162.68	298669.74
38	5000	298669.74	14933.49	7466.74	311136.48
39	5000	311136.48	15556.82	7778.41	323914.90
40	5000	323914.90	16195.74	8097.87	337012.77
<b>Total</b>	<b>200000</b>		<b>274025.54</b>	<b>137012.77</b>	<b>337012.77</b>
<b>Share investment income to MER:</b>		50.0%			
<b>Share final closing balance to MER:</b>		40.70%			
<b>Share initial contributions to MER:</b>		68.50%			