PENSION INNOVATION FOR CANADIANS: THE TARGET BENEFIT PENSION PLAN

SUBMISSION TO THE DEPARTMENT OF FINANCE, CANADA, FROM THE CONGRESS OF UNION RETIREES OF CANADA, JUNE 23, 2014.

The Congress of Union Retirees of Canada [CURC] is the recognized voice for retired trade unionists in Canada. CURC acts as an advocacy organization to ensure that the concerns of retirees and senior citizens are heard and addressed. Specifically, CURC's purpose is to petition legislators for the introduction and support of legislative measures to improve the health and welfare of all retired persons; and to fight for the rights of retired persons to have an equitable standard of living. Since its foundation in 1993, CURC has advocated for private and public sector pension reform as one of its highest priorities.

Pensions and pension security are major concerns for retired trade unionists. While there have been limited efforts over the years to alleviate the poverty endured by many people if they lived to be 60, it was only in the last half of the twentieth century that saw a dramatic improvement for seniors in Canada.

Today, these pension gains are at risk. Many of today's retirees face the problem of loss of or reduction in their pensions when their former employers go bankrupt; others lost much of their personal or defined contribution plans in the stock market meltdown. Tomorrow's retirees face even greater challenges. For many of them, the old advertising slogan Freedom 55 has now turned into the revised hope of Freedom 75.

PENSIONS: SOME BASIC FACTS

Currently, about 62% of working Canadians don't have a workplace pension plan, and more than a third of working Canadians have no retirement savings at all.

CPP covers about 93% of workers, but pays a maximum of about $1,038 a month.

The average OAS pension amounts to about $550 a month.

RRSPS cannot replace a public pension system. The median amount in RSSPs for those taxpayers nearing retirement is about $60,000, which is enough to buy an annuity of about $250 a month in retirement.

Employers have exploited the recession by threatening to either eliminate pensions for new hires; turn defined benefit plans into defined contribution plans; or drastically increase employee premium contributions and reduce benefits. As the events of the past years have shown, the reliance on RRSP type of arrangements is a risky one. Thomas Walkom, Toronto Star columnist, wrote on August 1, 2009:

The drive to dismantle the welfare state has a new target. Governments have already gutted insurance and social assistance. Out of-date labour laws make it tough to organize unions in the new, decentralized, service-based economy. Now, thanks in large part to the dynamics of the recession, pensions are under attack.

The proportion of retirees [seniors] in Canada's population will balloon to as much as a quarter of the population by 2030, from about 14 per cent now. Middle-class Canadians without a workplace pension plan or personal savings to fall back on face a sharp and sudden decline in living standards when they leave the work force.

With millions more retirees living on subsistence-level private and public pensions, the economy will see a lot less of discretionary income that has normally fueled consumer spending.

A recent report by the Organization for Economic Co-operation and Development warns that poverty among Canadian seniors is on the rise and that current pension safety nets may be inadequate to address the problem. For instance, as poverty rates were falling in many OECD countries between 2007 and 2010, in Canada, they rose by two percentage points.

As well, the report notes that public [government] transfers to seniors in Canada account for less than 39 per cent of the gross income of Canadian seniors, compared with the OECD average of 59 per cent, meaning more Canadians depend on workplace pensions.

The report also noted that public spending on pensions in Canada represents 4.5 per cent of the country's economic output, compared with an OECD average of 7.8 per cent.

Canadian seniors depend on income from private pensions and other capital for about 42 per cent of their total.

The OECD report notes that rising poverty among Canadian seniors is most acute among elderly women. Especially those who are divorced or separated.

" Higher poverty among older women reflects lower wages, more part-time and career gaps during a women's working lives" the report said while also noting " the effect of longer female life expectancy.......for which many women have not been able to save enough."

The OECD says Canada's current pension support, both private and public, replaces only about 45 per cent of average pre-retirement gross income, well below the two-thirds that many experts recommend.

CURC requests that all levels of government must act to face the fact that an increasing number of Canadians have no, or limited, pensions. There are approximately 11 million working Canadians with zero company-sponsored retirement pension plans...RRSPs are underused and skewed to higher-income earners and do not guarantee financial security since they are subject to market irregularities.

A majority of provincial governments are on record for supporting an expansion of the Canada Pension Plan [CPP]. The federal government countered by proposing Pooled Registered Pension Plans. PRPP plans are nothing more than RSSP plans. RSSP plans are under utilized currently so its reasonable to assume that PRPP plans will also fail to address pension security.

Governments and employers used the recession to attack workplace defined benefit pension plans and other retirement security provisions. Many defined benefit pension plans were in trouble as they were recording funding shortfalls. However, the health of Canadian pension plans improved to its best level in more than a decade in the fourth quarter of 2013 due to strong stock markets and rising long-term interest rates.

The Mercer pension health index, which tracks the funded status of a hypothetical defined benefit pension plan, stood at 106 per cent at December 31, 2013-its highest level since June 2001.

With improving investment returns and gradual increases in long-term interest rates, the funding status of defined benefit pension plans is improving significantly. For example, the defined benefit pension plan for Air Canada reported for 2013 a solvency deficiency of $3.7 billion. In January 2014, however, Air Canada announced the complete elimination of the pension solvency deficiency. The Ontario Teachers' Pension Plan also has reported that its solvency deficiency has been eliminated.

Mercer's is predicting that as the economy continues to improve that most if not all defined benefit pension plans will be fully funded.

Instead of proposing positive proposals to ensure the health of defined benefit workplace pension plans and to expand the CPP the federal government has proposed Target Benefit Pension Plans.

DESCRIPTION OF TARGET BENEFIT PENSION PLANS

Target Benefit Pensions are not new. They have existed for many years in the form of negotiated contribution Multi-Employer Pension Plans [MEPPs].

The federal government’s target benefit pension plan proposal contains the following components [Consultation Document]:

The proposed TBP framework would establish a middle ground between defined benefit plans, which offer a guaranteed pension backed by the financial position of the employer, and defined contribution plans, which provide a benefit that relies on investment returns.

TBPs would offer a new, sustainable and flexible pension option in which pension benefits and contributions can be adjusted to respond to the financial position of the plan.

The framework would allow defined benefit and defined contribution plans to convert to TBPs, should all parties agree, and would be available to any such pension plans created in the future.

It would be up to plan sponsors, members and retirees to determine the specific design of the plan.

The TBP framework would promote plan viability through the ability to adjust benefits and contributions to help ensure that the target benefit is met, and to deal with surplus or deficit situations.

The TBP should be equitably designed so that no undue transfers are made to one generation at the expense of another. All generations of members should be treated consistently.

There would be a joint governance structure that would reflect these risk sharing goals and ensure effective representation of employers, members and retirees.

TBPs would involve pre-specified contributions for employers and employees which would be independent of the funded position of the plan. Plan members and retirees would also be subject to investment risk.

***TBP benefit levels would be "targeted" rather than "defined" or "guaranteed", as they are under a defined benefit plan, and benefits or contributions could be adjusted according to the financial position of the plan. As a result, TBPs would not be required to be funded on a solvency basis*.**

Instead of requiring solvency payments, TBPs would allow pension benefits and contributions to be adjusted depending on the plan's financial situation in order to ensure the target benefit is met.

Contribution rates would be established by plan parties and could be adjusted based on the financial position of the plan.

PROBLEMS AND CONCERNS WITH THE TARGET BENEFIT PENSION FRAMEWORK PROPOSAL

CURC is of the opinion that one of the biggest drawbacks to the target benefit plan proposal is that the payout can be reduced if the target benefit is less than 100 per cent funded. This is not theoretical as an estimated 25 per cent of MEPPs have had to reduce benefits in the past

decade. In a single employer situation despite intelligent plan design features and the adoption of conservative investment, benefit and funding policies the prospect of benefit reductions in a target benefit plan can never be entirely eliminated.

CURC has a concern in that employees may have to forgo ancillary benefits, such as early retirement benefits. It should be noted that virtually every defined benefit pension plan contains some ancillary benefits but they do not tend to create problems because the extra cost is perceived to be borne by the employer rather than coming at the expense of fellow plan members.

CURC is concerned about the Guiding Principles section of the "Pension Innovation for Canadians: The Target Benefit Plan Consultation Paper" that states: ***that the pension model should promote intergenerational equity. For example, if costs for providing retiree benefits were not adequately valued, younger and future generations may be forced to bear this excess burden through higher contributions in order to pay for the retirees' ongoing pensions.***

This infers that retirees will lose or have a reduction of accrued pension benefits if the plan is in deficit. Stripping a benefit that was already being paid to retirees would be a contractual violation and should not be permitted. Retired members have met the employment obligations they owed to their employers. In exchange, they received the pension they earned through their work. Plan sponsors should not be permitted to escape their pension obligations. Members who have earned their benefits should not lose them for the convenience of plan sponsors. The intergenerational equity proposal is a 'red herring' that is attempting to create a problem that does not exist.

CURC is opposed to the proposal that defined benefit pension plans can be converted to target benefit plans. CURC has always supported defined benefit pension plans where benefits are guaranteed. CURC cannot accept a proposal that will reduce benefits that have already been guaranteed for years of past service. The change would adversely affect all current plan members, future members, as well as current and future pensioners and their survivors.

It should be noted that the rights of defined benefit plans were granted in good faith often following concessions at the negotiating table. This is a major concern among public sector retirees in New Brunswick who

are subjected to the "claw back" provisions of the New Brunswick "shared-risk" target benefit plan.

CURC is concerned that target benefit plans will have the effect of watering down the existing defined benefit plans that many employees of such companies and governments currently have. Target benefit plans would encourage employers with defined benefit plans to adopt something that costs employees more and offers them less while taking more risk.

CURC is of the opinion that this is the real agenda of the federal government: convert defined benefit pension plans to target benefit pension plans that will favour the interests of employers at the expense of employees. This will also be at the expense of stable retirement income that workers have already paid for through their pension contributions.

CURC is concerned that target benefit plan proposal as outlined in the Target Benefit Plan Consultation Paper does not guarantee that promised benefits will be maintained in retirement. The risk is completely shifted from employers and governments to vulnerable employees and retirees with limited financial capacity to absorb reductions in income.

CURC calls upon the federal government to stop any move to incorporate into The Pension Benefits Act, 1985, provisions for Target Benefit Pension Plans for federally regulated pension plans or any other pension plans.

DEFINED BENEFIT PENSION PLANS

Defined benefit ["DB"] pension plans are the cornerstone of Canada's economy. In each of 2011 and 2012 these plans collected between $44-47 billion in mandatory contributions from members and employers, and paid out between $68-72 billion in benefits.

Figures provided by four major Ontario pension plans show that the vast majority [up to 80 cents] of each pension dollar paid out comes through investment returns, which in turn come from sound funding policies and "best in class" investment results at home and abroad.

In a recent study by the Boston Consulting Group [BCG] show the many

benefits of defined benefit pensions including: a very low cost of investing; investment expertise that allows them to generate up to 80 per cent of a fund's assets through investment returns; shared longevity risk; and the ability to invest in areas that the average person can't access, such as real estate, private equity, hedge funds and infrastructure.

Defined benefit pension plan members tend to be more financially secure than non-members since they have a guaranteed and sustainable pension.

Defined benefit plans are far better vehicles for pension savings from both a security and a cost basis for both employees and sponsors.

Instead of pitting the public sector and the private sector and defined benefit plans with target benefit plans the federal government should ensure that all Canadians have access to reliable and secure defined benefit workplace pension plans so that they can be guaranteed a secure and reliable pension in retirement.

To this end, all levels of government should ensure that all defined benefit plans are sustainable, well funded and actuarially sound.

The federal government and the provinces/territories should immediately take the necessary steps to expand the Canada Pension Plan. The expansion of the Canada Pension Plan is the best way to enhance the retirement security of Canadians.

CONCLUSION

The Federal Governments voluntary shared risk target benefit pension plan proposal is not the solution to create a secure and sustainable pension for retirees. The target benefit plan proposal permits the reduction of accrued benefits [otherwise illegal under the Pension Benefits Act] for active members and pensioners, and where automatic future indexation of accrued benefits is included in the terms of the existing plan, indexation is made contingent on the plan's funded status. This is a radical departure from defined benefit pension plans where accrued benefits are protected by law.

The target benefit plan or shared-risk plan will have the effect of

watering down existing defined benefit pension plans. Companies and governments that currently offer defined benefit plans will be encouraged to adopt target benefit plans that cost employees more and offer them less while taking more risk.

CURC recommends that the federal government stop any move to incorporate into The Pension Benefits Act provisions for target benefit pension plans.

CURC recommends that the federal government take steps to ensure that existing and future defined benefit pension plans are sustainable.

CURC recommends that the federal government along with the provinces/territories expand the Canada Pension Plan.