



**RESPONSE TO FINANCE CANADA  
REQUEST  
FOR CONSULTATION  
ON  
PENSION INNOVATION FOR CANADIANS**

**“THE TARGET BENEFIT PLAN”**

June 22, 2014

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# PART 1

## **1.0 EXECUTIVE SUMMARY:**

The Pionairs advocate on behalf of 28,000 Air Canada retirees in ten Air Canada defined benefit pension plans, of whom more than 15,000 are Pionairs members. We are also a member of the Canadian Federation of Pensioners whose collective retiree organization advocates on behalf of over 250,000 retirees. On behalf of all these Canadian citizens and defined benefit pension plan retired members, we would like to express our appreciation to Finance Canada for the opportunity to contribute to what we consider to be an extremely critical consultation.

The implementation of a Targeted Benefit Plan (TBP) may be of benefit to employers who do not have a pension plan for their employees. The TBP will principally assist employers who require funding relief from their existing defined benefit plans. For active employees, a TBP may be preferable as an alternative to a defined contribution plan or an RRSP as a TBP would allow them to benefit from professional investment expertise, economies of scale in investment and administration, , and longevity pooling.

However, conversion to a TBP would be highly detrimental to retirees in existing defined benefit plans. The focus of this Commentary is to make clear the position of such retirees as to such a conversion.

We note that in the Introduction to the Consultation Paper, there are no questions directed to pensioners/retirees who are those most affected by the proposals. Fundamentally there is a need in Government to respect the rights of retirees/pensioners who, as long time citizens, paid taxes to, fought for, and continue to support Canada. These individuals are least able to support their livelihood at this time in their life. We do not believe that the Government should shift the responsibility of protecting retirees to the retirees themselves, which is the effect of TBPs generally, and particularly in a conversion to a TBP. To be clear, the opportunity to dissent to a 33 1/3 per cent level and even at an individual level is not an effective protection for retirees. Particularly for elderly retirees or their beneficiaries the issues are too complex, and the implications are too unclear.

The existing private pension plans have served Canada's citizens well for many years. Recent initiatives are reinforcing the nation's retirement system. It is therefore difficult to understand the reason to undertake an additional plan (Target Benefit Plan) for existing plan retirees. The existing DB plans have served retirees well except for the lack of protection in insolvency proceeding under the Canadian Companies Arrangement Act (CCAA) or Bankruptcy and Insolvency Act (BIA). There would be even less protection for retirees in TBPs in insolvency proceedings unless insolvency legislation is amended.

From the perspective of retired members of a defined benefit plan, the TBP provides significant pension cost relief to employers. These are plan sponsors who have DB plans whose costs are volatile under current world environments. The TBP does not, however,

confirm any benefits to retired members of existing defined benefit plans. There are no perceived benefits and only risks to these individuals. Their existing means of livelihood is placed at risk. Their ability to rely on a promised income is threatened and in the event that benefits are reduced, they have little or no ability to make up lost income.

Many if not most defined benefit plan retirees entered employment and agreed to a mandatory defined benefit plan; some contributed to the plan throughout their entire working career. They have responsibly planned their retirement based upon the pensions that they earned. Many of the pensioners participating in a company DB pension plan were unable to contribute to an RRSP plan therefore were totally reliant on the DB plan for retirement income. To have this livelihood withdrawn without their knowledge and consent and an opportunity to effectively reject conversion to a TBP: a) is to have this very significant portion of their incomes reduced or rendered less secure, and b) would be a travesty of their earned rights.

Accordingly, the Pionairs, can support the creation of TBPs as a government initiative only if existing retired members of defined benefit plans are fully protected. We believe that settlement of their benefits by an annuity purchase on the conversion is the preferable protection, or exclusion from the proposal. For such retirees, the consequences of a conversion:

- Reduction of benefit security arising from a lower level of required funding
- Risk of loss of firm pension income
- Little or no ability to recover from pension reductions
- Little or no ability to improve their current pension
- Continued concern for their future livelihood.

## **2.0 BACKGROUND**

### **2.1 Current Status – Canadian Pension System**

Canada has a well-founded pension environment to ensure that its senior citizens are, in fact, provided the means to live in dignity and avoid becoming “wards” of the state, dependent upon social security at the expense of taxpayers. This pension system is founded upon three pillars:

1. The Canada Pension Plan, administered by the Government
2. The Old Age Security and the Guaranteed Income Supplement, provided by the Government
3. Pension plans committed and contracted by public and private sector sponsors, and individual savings, encouraged by Government through special tax considerations (RRSP, RRIF).

The first two pillars have remained viable for several decades and are serving the elder community well. The third pillar, particularly to the extent it is the responsibility of the private sector, has become severely dependent on economic cycles, the morality of the investment community, and the capability and dedication of individual sponsors. The result has apparently been non-sustainability for privately sponsored defined benefit pension plans.

For over a decade, in response to the inadequacies existing in this third pillar, both pressures upon employers and the lack of pension coverage in the private sector, governments (federal and provincial) have commissioned studies, reports, meetings, annual Parliamentary examinations, and proposed legislative changes. The TPB is the most recent of the proposed legislative changes.

### **2.2 Current Status – Private Pension Plans**

For at least ten years the private pension system in Canada has been under threat:

- a) Low interest rates
- b) Economic Upheavals
- c) Inadequate investment capability
- d) Regulatory legislative conflicts, sponsor commitment
- e) Corporate insolvencies.
- f) Contribution holidays

These have resulted in a high number of defined benefit pension plans with less than the solvency funding required by pension legislation (OSFI Reports).

During the last ten years, the Government of Canada and some provinces have attempted to rectify the crisis by introducing legislation designed to reduce the burden on plan sponsors to maintain viable pension plans by easing solvency funding requirements.. However, the sponsors, in order to attract employees, had committed and in many instances still do, contract with employees to provide firm, fixed pensions through defined benefit plans. There are alternatives to defined benefit plans: defined contribution plans, pooled registered pension plans, and now a proposed “Target Benefit Plan”, which will increase the number of plans available to employers to offer employees. Such alternative plans are all designed to reduce the commitment by and financial risk to plan sponsor, while they increase the risk of achieving adequate and secure pension and income to the employees and existing retirees.

There have been measures directed to relieving employers from the funding pressure resulting from economic and market conditions. Relief from solvency funding requirements by extending the time for such funding has been provided in regulations to the Pension Benefits Standards Act, 1985 (PBSA). The PBSA permits benefit reductions under carefully controlled circumstances. In 2012, the federal Government introduced the distressed pension plan workout scheme under the PBSA to further permit relief to plan sponsors from some of their fiscal responsibility to their retirees.

This submission will review the pension environment created by the various employer relief mechanisms on the third pillar. It will stress the overall impact on those individuals who have relied on their promised, contracted, committed and earned pensions, and whose livelihood is disrupted by the disintegration of the pension promise and contract, with no ability to replace the income secured by that promise.

### **3.0 INTRODUCTORY DISCUSSION**

#### **3.1 Existing Pension Plans Affectivity :**

A brief review of the current pension plans available to the private sector can establish an environment for submission and comments on the proposal for an additional type of plan.

##### **3.1.1 Defined Benefit Plans**

Defined benefit plans have been an integral fact of the Canadian pension system for many decades. Up until the last decade, with its: a) extraordinary economic climate, b) contribution holidays, and c) corporations being embraced by varying types of investor and investment instruments (Hedge Funds, Credit Default Swaps, BIA protection for creditors, internationalization of pension sponsors) most of whose objectives are to reduce or terminate the pension cost to the corporate sponsor, the system has worked well. Defined benefit plans were advantageous to both sponsors and beneficiaries. In fact, the economics of the plans were so viable that sponsors were able to take long term pension payment holidays while the plans were not only fully solvent, but generated returns surplus to requirements

Many professional pension advisory organizations continue to confirm the efficiency of defined benefit plans in meeting their goals and objectives (CIA 22 Nov 2012). In addition, over all of these decades, many millions of senior citizens have been able to retain their livelihood due to the certainty of the defined benefit plans.

Because defined benefit plans provide predictable income for individuals who are without other income options (elderly, disabled seniors, etc.), these plans facilitate both retirement planning and retirement. Defined benefit plans help shelter plan members from the risks associated with low interest rates, market volatility and age related issues. These plans utilize the volume of funding contributions to create larger investment pools which, over time, generally have provided more than adequate returns to sustain the fund's viability in a free market environment.

The longevity of defined benefit plans that have existed for years in a viable and sustainable manner, confirms their effectiveness. The events of the last decade have put major strains on the plans; however, there are a number of measures that could be taken under current legislation under which the current plan stress would be ameliorated:

- Greater use of distressed plan work schemes

- Utilization of the extended solvency recovery period currently provided by special regulations
- Encouraging sponsors to make contributions to develop surplus by effective changes to the tax rules.
- Recognizing the lack of security for members of underfunded defined benefit plans when sponsors seek CCAA/BIA protection, and revising the CCAA/BIA priority schemes to integrate the security requirement of the PBSA. Such legislation would allow retirees to be increasingly flexible with sponsor requested solvency relief.

### 3.1.2 Defined Contribution Plans

For several decades, pension plan sponsors have had the option of offering employees a pension plan which de-risks the volatility of the sponsor's contribution by permitting a fixed contribution, both by the sponsor and the employee. The employee then has the responsibility of selecting investments for the total contribution in his pension fund in a financial vehicle of his choice.

The risk of achieving the employee retirement financial goal is lifted from the sponsor. In insolvency, the liability of the sponsor ceases and the individual's investment remains his responsibility to invest for his retirement.

The impact of defined contribution plans and their less regulated cousins, Group RRSPs, will begin to be seen when long time members of such plans begin to retire.

### 3.1.3 Pooled Registered Pension Plans (PRPP)

The PRPP is a new Government regulated plan for individuals in SME organizations or self-employed individuals. Contributions are pooled and invested by an administrator. The employee's employer may make contributions but bears no risk should the company become insolvent, terminate the plan, or the PRPP investment does not perform to meet the individual's retirement requirements. It is an alternative method, intended to be low cost, of achieving funding growth for individuals and distributing the risk through professional investment management and a pooled fund. While these plans are good, the reduction in contributions to an RRSP reduces the individuals possibility to increase their ability to personally help themselves by contributing to an supplementary plan. The advantage to employers is the absence of legislated fiduciary duty, and the shift of the expenses of administration to plan members.

As with defined contribution plans, the risk of achieving the employee retirement financial goal is lifted from the sponsor. In insolvency, the liability of the sponsor ceases and the individual's investment remains his responsibility to invest for his

retirement. It is not yet known whether such plans will be successful in increasing pension coverage and adequate retirement funds of their members.

#### 3.1.4 Proposed Target Benefit Plan

The introduction of target benefit plans can fulfill a perceived void in the private plan pension structure. A plan with a defined benefit formula, where the investments are handled by expert professionals, and the members share the risk of longevity, could be beneficial in specific circumstances and environments:

- Companies who do not have any pension plan and wish to provide one that is preferable to a defined contribution plan for employees and that does not have the financial risk to the company of a defined benefit plan.
- Employees with defined contribution plans who wish to pool investment and longevity risk, have low cost professional management, and decrease costs so as to enhance the funds value to meet their retirement needs.
- Those sponsors with defined benefit plans who wish to control the costs of such plans.

Target benefit plans do not, however, provide any benefit to those individual retirees whose defined benefit plans may have existed for many decades and on which their livelihood is predicated.

We do observe that TBPs although they would ease the funding pressure on employers with existing defined benefit plans, are unlikely to increase pension coverage. It is difficult to see why employers in non-unionized environments who do not presently offer a pension plan would establish such a plan, given the simpler alternatives.

In summary, a TBP may fill a small void in the private pension system, but that gap can be filled within the existing system. There are circumstances and environments in which a TBP would do more harm than good, and are in the category adhered to by the medical profession on any medical procedure they propose to do, as “Do No Harm”. The following not only define the reasons for the harm being done to current defined benefit retirees and pensioners, but also have elements which need to be enshrined in the legislation to mitigate the effects of a TBP Plan.:

### **3.2 Protection of Retirees as Public Policy**

We submit that public policy requires that retirees should be given special consideration in legislation and policies respecting target benefit plans. There is no other protection for retirees. There is no economic advantage to the employer or any other stakeholder in protecting retirees. The interests of the active members may actually conflict with the interests of retirees.

Retirees and their beneficiaries are vulnerable financially. Retirees have no means of increasing their incomes or savings to compensate for a reduction in their pensions. Their bargaining power with their employer consists largely of good will. Many retirees or their beneficiaries already exist on very low pensions, particularly those who are many years past retirement, whose pensions did not keep pace with inflation. They cannot absorb a decrease in benefits.

Retirees are geographically dispersed, are probably not personally knowledgeable or able to absorb complex pension information, particularly as they get older, do not have access to expert financial advice, and may not be electronically sophisticated. Some may not have email. Many do not respond to requests for consent or expressions of dissent. Beneficiaries (spouses of deceased retirees) are in an even more vulnerable position.

Retirees are particularly vulnerable when the employer of an underfunded plan becomes insolvent. There is little protection for retirees under the CCAA, whether under the legislation, in CCAA proceedings, and in judicial decisions. The interests of sophisticated secured creditors generally prevail. There is even less protection under the BIA. The unfunded liability of a plan has only the status of an unsecured debt under the BIA. The target benefit plan proposals encapsulate this situation. If the funding of the plan is insufficient, the benefits are simply reduced. And with the elimination of solvency funding, there is an increased probability that the funding on wind up will be insufficient.

There is currently a great deal of emphasis on Canadians saving adequately for their retirement, and a concern for the taxpayer in providing a safety net for those who do not or cannot. This has led to increasing the age for OAS entitlement, legislation enabling the creation of PRPPs, and discussions of increasing the CPP, or in Ontario the creation of an OPP. We observe that legislation permitting benefit reduction to employees with pension plans is inconsistent with the direction of the government to provide workplace pensions and accordingly to make retirees self-sufficient. It is totally unfair to current retirees and near retirees who have planned their retirements responsibly on the basis of the pensions they have earned.

### **3.3 Perspective of Major TBP Stakeholders**

#### **3.3.1 Perspective of Employers**

The advantages to employers of Target Benefit Plans in lieu of conventional defined benefit plans are clear:

- Relief from the financial burden of solvency funding, even with funding margins
- Improvement in balance sheets

- Improved borrowing ability
- Ability to offer or negotiate benefit improvements without a firm obligation to fund
- Transfer of risk of investment returns and interest rates to plan members
- Reduction of responsibility and involvement in plan governance
- Minimal plan member involvement in formal or informal insolvency proceedings.

### 3.3.2 Perspective of Active Members

From the perspective of active plan members, although their benefit security will be compromised, there are sound reasons not to defeat an employer's proposal to convert a defined benefit plan to a target benefit plan, if the alternative is a plan wind up or conversion to a defined contribution or other capital accumulation plan. The interests of active members:

- Financial health and survival of the employer for continuing employment
- Desire to continue accruing pension benefits
- Avoidance of individual investment risks that are a feature of money purchase arrangements
- Pooling of investment and longevity risks
- Opportunity over time to reverse adverse changes in the plan such as contribution increases or benefit reductions
- Recognition that employee satisfaction is of value to company

Where it is necessary to increase contributions, which would have to be made by the active members, and not by the retirees, or reduce benefits, the actives may well prefer to reduce benefits, hoping they will be made up before they retire.

### 3.3.3 Perspective of Retirees

Neither the possibility of a plan a plan wind up nor a conversion to a money purchase arrangement for future is a serious problem for retirees, assuming the company is not insolvent. From their perspective:

- A potential decrease in pension benefits was not included in their terms of employment, or in the terms of their retirement upon which they are entitled to rely.
- Security of pensions is compromised with reduced funding and possibility of benefit reduction. Pensions in pay have inherent benefit reductions because of inflation.
- Retirees have little or no ability to compensate by employment or increased investments for benefit reductions
- On a plan wind up, where the employer is not insolvent, their benefits will be fully funded, although over five years – provided the employer does not enter BIA/CCAA during this period.

- Assumption, with the active members, of the risks of investment returns and interest rates
- Little interest in involvement in plan governance and expectation of a lesser voice in plan and major policy amendments than active members
- Would prefer contribution increases to benefit reductions, in opposition to the interests of active members
  
- In the event of an insolvency of the employer, the retirees would have less voice, if there would indeed be a voice at all, where the plan is underfunded.

If the only alternative to conversion of an underfunded defined benefit plan TBP is the insolvency of the employer and consequent CCAA or BIA proceedings, retirees would arguably be better off to at least have the current transfer ratio of their benefits secured by an annuity purchase by the employer with the possibility of an increase if the employer and the plan recover.

## 4.0 CONCLUSIONS

It is accepted that, under current economic conditions, pension plan sponsors are desirous of minimizing the risk of having to fund solvency deficient pension plans. It must also be recalled that, for some decades, the investments made to support defined benefit plans were sufficiently successful to not only pay for the plan but also allow the sponsor to take contribution holidays. However, not all defined benefit plans are fully funded by the sponsor. Many have at all times or for a period in the history of the plan shared contributions where the employee makes equivalent contributions. With these plans, when the sponsor took holidays, the employee continued to make contributions. There should be no asymmetries in pension plan funding without compensation.

Concurrently, there exist sufficient alternatives to pension funding for sponsors, ranging from funding relief under the distressed pension plan work out scheme to the defined contribution alternative, to a reduction of benefit under OSFI supervision, and finally the pooled registered pension plan to accommodate the concern without having to take on an asymmetric risk without matching reward.

TBP plans remove funding risk from the sponsor and transfer it to the employees and ultimately to the pensioner (except in the case of insolvency where the plan members bear a huge portion of the risk). . It needs to be also noted that DB Plans also put the risk on the retiree on the occasion when the employer/sponsor elects to enter BIA/CCAA.

In all previous alternatives (DC/PRPP), plan introductions and conversions were not applicable to individuals who were no longer contributors to their plan and were receiving their payout in accordance with the promise and contractual agreement entered into during their employment. Over many years (some retirees have been retired for 25 years or more) the DB plans have morphed through many revisions. These revisions in governance and terms have resulted in significant differences between schemes applicable between generations. To convert a highly complex set of agreements affecting thousands of individuals will only be expensive and time consuming, without immediate benefit. Existing pensioners need to be allowed to retain their entitlements already earned under their DB Plans.

**The balance of this Commentary will follow the headings in the Consultation Paper, with additional headings as needed.**

## **PART II**

## **2. SUMMARY – LEGISLATIVE AND REGULATORY FRAMEWORK**

We agree generally with the bullet points in the Summary of the Consultation Paper. There are several key clarifications as to our position that will be expanded upon under the appropriate heading.

The governance policy should specifically address the participation of retirees in plan governance (Bullet 1).

The funding policy should be based on a Provision for Adverse Deviation (PfAD) tailored to the plan provisions, the investment policy and the demographics. We believe a probabilistic approach will not be readily understood by plan members (Bullet 2).

### **3. OBJECTIVES AND PRINCIPALS**

#### **3.1 Objectives**

The objectives that are articulated in the consultation paper are pension sustainability and benefit security. For sustainability, the Paper calls for an acceptable range of costs for employers and plan members and risk management. We point out that retirees have already paid the costs of their pensions. The design of the Plan must also not only be fair and equitable, but for retirees, must be seen to be fair and equitable. Retirees do have an interest, however, in risk management.

Our focus in this commentary is upon benefit security. There is little point to retirees in sustainability unless there is benefit security. The primary purpose of a pension plan is to provide a promised and contracted level of pensions.

##### ***3.1.1 Pension Sustainability.***

- The objective is acceptable; however, it should not be at all costs. Over the last fifty years the market has overwhelmingly provided adequate returns to maintain, not only plan sustainability, but also generate surpluses. It is only because these surpluses were used to take pension holidays in lieu of being invested, which combined with artificial Government mandated low interest rates and excessive market events that plan sustainability began to be questioned. It should be noted that while sponsors were able to take contribution holidays, employees continued to make their contributions during the holiday periods.
- Risk attribution must not be asymmetric. In defined benefit plans, the risk is born symmetrically by the employer in making required contributions and by the employee with the risk of the employer's insolvency.

##### ***3.1.2 Benefit Security***

- The objective is well stated. There is a need to consider the extent to which it is achieved and by whom. In current circumstances, this security is provided by a) good management and b) economic cycles when not affected by artificial influence. All remain applicable.
- In recognition of a policy of "fair and equitable", there is an additional significant requirement (which does not exist today) to provide reasonable weighting to the most vulnerable, so that their rights are protected.

#### **3.2 Guiding Principles**

### ***3.2.1. Transparency***

We agree. We refer to the information that is required to be given to plan members in the OSFI 2012 Reducing Benefits Guidelines as a condition for the Superintendent's authorization of a reduction in accrued benefits. This should be incorporated into legislation or regulations with such changes that are appropriate. It is also critical to establish who has responsibility to develop the issues, which need to include all the consenting parties.

### ***3.2.2 Equity***

We note the concern with intergenerational equity. The concern seems to be the burden on the active members of helping to fund, with their contributions, the underfunded benefits of the retirees. We point out that many, if not most, retirees have not had their pensions increased consistently with the effective increases given to active workers through improvements to benefit formulas generated by contract negotiations and through salary increases. In the history of a plan, member contributions may have been required at some period or periods. Nor are pensions increased commensurate with inflation. Older retirees in particular see and will continue to see the purchasing power of their pensions decrease substantially.

Over many years (some retirees have been retired for twenty-five years or more) a defined benefit plan may have morphed through many revisions. These revisions in governance and terms have resulted in significant differences between schemes applicable between generations. To convert a highly complex set of agreements affecting thousands of individuals to perfectly equitable arrangements will only be expensive and time consuming, without immediate benefit.

What is clear is that across the board benefit reductions consistently given for actives and retirees create inequities for the active members and recently retired members.

We urge that the solution to real or perceived future intergenerational inequities is to purchase annuities for the retirees on the conversion of the plan, with an employer top up if required. This might require special consideration being given to active members close to retirement.

## **4. TARGET BENEFIT PLAN ELEMENTS**

### **4.1 Administration and Governance**

#### ***4.1.1 General Commentary on Considerations and Proposed Approach***

We refer herein to the governance body for a TBP as the Board of Trustees. .

The Consultation Paper references participation by retirees in the governance process.

Retirees are geographically dispersed, are probably not personally knowledgeable or able to absorb complex pension information, do not have access to expert financial advice, and may not be electronically sophisticated. Some may not have e-mail. Many do not respond to requests for consent or expressions of dissent. Beneficiaries (spouses of deceased retirees) are in an even more vulnerable position.

However, we believe that participation in plan governance through retiree representatives is beneficial and may effectively improve the day to day administration of the plan. Notwithstanding such participation, retiree representation will probably not be effective in decisions with regard to the reduction of benefits in an ongoing plan in opposition to active members or employers. It is therefore important that first, legislation protect retiree benefits; and secondly that retiree representatives have a true and effective voice at the governance table, and thirdly, that there be a fair weighting of votes.

The value of retiree representatives is to:

- keep the interest of the retirees before the Board of Trustees,
- provide guidance on issue critical to retirees
- ensure communications to retirees are timely, and
- to be vigilant for conflicts of interest

Up until now, this has not occurred in pension plan governance since each participant in the plan governance model has a different objective and agenda, and retirees have not had a seat at the table.

#### ***4.1.2 Duty to Plan Parties***

Participation of retirees in the ongoing governance requires the selection of strong representatives, either selected by the retirees, if they have an organization, or appointed to act in their interests. If the initial representatives are self-selected or appointed, the selection must be confirmed by the retirees at large.

Conflicts of interest with active members and employers cannot be avoided. Accordingly, it is essential to have very clear and detailed provisions in the plan text at the outset setting out the order in which contributions will be increased, ceilings on contributions if any, the order in which benefits will be reduced, and the order of a contribution decrease or reinstatement of benefits where the funding permits. Further, there needs to be a ratio of voting rights established appropriate to the element of risk and the extent to which the risk negatively impacts the objective of protecting the pensioners' benefits.

#### ***4.1.3 Regulatory Flexibility***

Effectiveness of the administrative body will not only depend on flexible federal regulatory framework which currently exists (DBWS), but also the consequences to administration if they do not adhere to these regulations.

#### ***4.1.4 Effective Decision Making***

Recognizing the disparity in function, mission and objectives, achieving this type of governance must include an agreement to act in good faith by all participants and a means to resolve perceived or actual discrepancies. There should also be the avenue of appeal by any of the concerned parties to an independent party to insure the rights of all parties are protected. This necessarily involves a legislated duty to plan members as there is currently in the PBSA.

#### ***4.1.5 Unionized Management***

The comments above remain applicable.

#### ***4.1.6 Representation***

In the normal course of plan governance, the interest of employers, actives and retirees are similar – appropriate investments of the pension fund, accurate and efficiency in plan administration, appropriate funding policy, member communications and compliance. However, when the issues are an increase in contributions or a reduction in benefits, the interests of active members and retirees will differ. The burden of increased contributions obviously will fall on the active members; the greater burden of a reduction in benefits to the extent it affects retirees, falls on the retirees, who have no means of making up for any loss in income. It is unlikely that one or two or even three retiree representatives (and there should be at least three for a critical mass) would have much influence in such decisions. They could and would certainly be outvoted. Accordingly, as stated above, there needs to be an appropriate ratio of voting rights.

We also believe that the employer should participate in plan governance. The risks of the pension promise have been shifted to the members. The employer

should retain a fiduciary obligation to plan members with respect to the investments and funding policy of the plan. Moreover, the employer's senior staff can bring financial and human resource expertise to the administration of the plan.

#### ***4.1.7 Proposed Approach***

We agree with a joint governance structure, including the employer, active members and retirees and beneficiaries, with the ability and mandate to engage professional advisors, and with fiduciary duties to the Plan Members.

##### *Governance Policy*

We agree that there should be a governance policy, setting out the matters as in the Consultation Paper. We would add an item for initial and ongoing training programs for members of the Board of Trustees. . The governance policy should be in a standalone document for easy access that is available, in a timely fashion, to plan members. We suggest that OSFI issue Guidelines that pertain specifically to the governance of Target Benefit Plans.

As to the skill sets of members of the Board of Trustees, it is indeed necessary that the members among themselves have a high level of expertise. This could be problematic depending on how member representatives are selected. Its members should have such expertise and/or have the mandate to retain expert legal and actuarial advice, and members must receive robust initial and ongoing education and training in plan governance. The Board of Trustees should be mandated to retain expert legal and actuarial advice where required.

It has been suggested that there be independent members on the Board of Trustee's. This would be desirable, from the point of view of member expertise and for conflict resolution. Independent members would, however, have no vote on pension issues.

##### *Nature and composition of the administrative body*

See comments under *General Commentary on Considerations and Proposed Approach*. Additionally, there should be enforceable sanctions when the fiduciary duties are not carried out. Conflicts of interest are unavoidable, and the areas where these will arise, contributions and benefit reductions, must be addressed in the plan text.

#### ***4.1.8 Role of the Plan Administrator***

A key issue, assuming the representation by members, retired members and the employer on the Board of Trustees is the exercise of their powers with respect to the cornerstone elements of the governance and administration of the plan:

- Plan text

- Governance policy
- Funding policy
- Surplus utilization policy
- Deficit recover policy

Amendments to these cornerstone documents, should be made by the Board of Trustees in accordance with the voting ratio, and then approved by members. The appropriate voting ratio is 35 per cent retirees, 32 per cent company, 33 per cent active, with a slightly higher percentage for retirees since their risk is greater and they do not benefit from good plan performance.

We suggest that the plan text and the key policies listed above be annexed to the plan text as Schedules, and their revisions require the consent of members, retirees and the employer, with the member consent mechanism discussed above. Clear and adequate information must be given to plan members and retirees and the amendments are subject to majority consent from each of the parties (sponsor, active employees, and employees).

The Board of Trustees should be able to authorize minor housekeeping and compliance amendments to the plan without recourse to member consent or approval.

## Questions

- **Is this governance framework appropriate for federally-regulated private sector and Crown corporation pension plans wishing to convert to a target benefit plan?**

Yes, subject to the comments made above and the requirement to exempt existing DB pensioners from the TBP..

- **Should the federal legislation or regulations be prescriptive regarding the composition of the governance body (e.g. proportion of plan members and retirees, presence of independent trustees)?**

We suggest that OSFI issue Guidelines for a governance policy for TBPs. Legislation or regulations would be either too prescriptive to meet the needs of different plans or be too vague.

However, there should be a general legislative or regulatory requirement for a body with representation from active members, retirees and the employer, and relief from personal liability where the member has carried out his/her duties in accordance with the existing legislated standard of care, including reasonable reliance on experts. The requirements for initial and ongoing education and training of members of the governance body probably belong in the Guidelines.

We do not believe that the employer alone through its directors or staff should constitute the governance body, having transferred the risk of interest rates and investment to the members. However, the employer should devote financial and human resources expertise to the governance of the plan.

Legal and actuarial expertise must be available to the governance body. Such advice should be independent. There is a serious issue of cost for such expertise, and for independent members of the governance body, which is not addressed in the Consultation Paper.

Independent members, if they could be found, could potentially play a useful role in resolving conflicts among the members of the governance body. However, it is more important that the funding, deficit recovery plan and surplus utilization are set out in detail in plan documents, and there be independent legal and actuarial advice available.

- **Should the Board of Trustees have powers to amend plan documents?**

See above. Amendments to cornerstone documents can only be made with the approval of the Board of Trustees, with the weighted voting noted above, and the majority consent of the employer, active members and retirees.

- **What should be the plan member support level requirement for making substantial amendments to the plan text?**

See above. The plan members must give approval by a majority in each class (actives, retirees).

- **Should there be different governance framework provisions applicable to federally regulated pension plans in unionized and non-unionized environments?**

Yes. Member representatives in non-unionized plans cannot compel the consent of these members. A union can do so. This paper deals with non-unionized workforces. We do note the protection is needed for retirees in unionized environments where the union may represent the active workers and not the retirees.

- **What type of process could be used for negotiating provisions of the plan with employers in federally regulated non-unionized environments?**

Representatives of retirees should be appointed by the retirees or the representative organizations and ratified by the membership, with an opportunity to challenge. Court approval may be required to assure greater certainty of legitimate representation. The representatives should have their reasonable expenses, including legal and actuarial advice, paid for by the employer, not by the plan. Membership

lists should be available to the representatives for direct communication with the members. We refer to the process in the distressed plan workout scheme.

## **4.2 Funding Policy**

Funding policy is critical to the successful sustainability of a TBP Plan. The objectives have been clearly stated:

- Plan Sustainability
- Reduced Cost to sponsor

The process for adjusting sponsor costs and risks as currently exists for defined benefit plans results in increased risk to the retiree/pensioner and increased cost in the event of lack of target achievement or sponsor insolvency. These negative impacts on retiree pensioners will require individual consent for conversion by each retiree/pensioner.

Transparency in plan funding is also required to establish for all participants the going concern liability upon which the target benefits are based, but also the actuarial solvency liability so that all stakeholders can be aware of their wind-up exposure and their termination exposure..

### ***4.2.1 Considerations***

#### ***4.2.1.1 Funding for DB Plans***

As previously defined, funding for the TBP will be set by negotiations of stakeholders along with other policies. Any changes to the funding should be approved by a majority of all the participating stakeholders, sponsors, active employees, and retirees having the same vote ratio as originally agreed.

The funding for defined benefit plans for the last five decades has been based on maintaining the security of the pension which was earned by and paid for in some cases with employee contributions, by retirees over their working lifetime. A recurring solvency ratio report is required to ensure that the promise/contract of the employer with the employee is being sustained. In current volatile financial times, and the employer's ability to generate financial data extremely rapidly, an estimated solvency ratio should be provided at least quarterly. It is understood that the purpose of the TBP is to relieve the employer from producing an actuarial solvency ratio and also to shift the financial risk and security of the defined benefit plan to the employee and retiree. As a consequence of the change in the basic framework and financial liability for the plan, it is more than ever necessary to have current information on plan financial status. This requirement becomes increasingly critical in the event "an open group" is agreed in negotiations.

#### ***4.2.1.2 Benefit Protection***

Recognizing that the stability of pension plan security was and is the basis for the structure of defined benefit plans, it is understood that these basic safeguards to retirement

security will no longer exist in the TBP Plans. Government, therefore, needs to construct the structure and basic requirements for the TBP so that the loss of their pension accruals does not occur at a time in life when retirees are unable to rebuild their economic status.

#### *4.2.1.3 Unique Features of TBP Plans*

We are in agreement with the Government's assessment of the TBP features. Unfortunately the premise that corporations/employees would continue for a long time is weakening in the current world. To quote Jeff Bezos, CEO of Amazon.com "companies come and go". The construct of the TBP must acknowledge this fact and enshrine policies which protect the employees and their investment when in fact the employer is no longer in existence. The funding rules require a greater scope than as proposed

#### *4.2.1.4 Funding Margin*

We believe the Funding Margin should cover, with certainty, the full pension value to current retirees. For all new plan members, who were not previously an existing plan member, the margin needs to be set by negotiation. The quantum of the PfAD should be set by the negotiators for the particular plan (e.g. for a low expectation plan, the margin may be high, for a high expectation plan, the margin may be low

The lower the financial requirements to support the plan, the greater the reduction in cost to the employer versus the cost of funding defined benefit plans for solvency. This will necessitate establishment of an adverse deviation protection (PfAD) somewhat better and higher than currently required for defined benefit plans. The Income Tax deductible contributions for members and the employer is currently 125% in the event a surplus is achieved. It would be reasonable to set the measure for adverse deviation (acquired from any plan surplus) to a minimum of 125% since the amount received to meet "going concern" in lieu of actuarial solvency requirements is significantly less than for defined benefit (can be as much as 30% - 100% less).

The requirement for a minimum full solvency at all times must be legislated with enforceable penalties in view of the gap which generally exists in solvency results of going concern to actuarial solvency measures.

#### *4.2.1.5 Probabilistic versus Margin Approach*

As a policy, at no time should contribution holidays be permitted and that requirement needs to be enforceable under all circumstances. Excess funding can be used to :

- replenish retiree pensions which may have been previously reduced (and note we believe retiree pensions should be protected) :
- replenish other pensions which have previously been reduced
- permit buildup of a PfAD
- at least have some funding available in the event of insolvency

While a probabilistic approach is an interesting concept, it suffers from at least three severe flaws:

- The bases for establishing the probabilistic value often have not considered all elements which impact the analysis
- The ability to calculate a probability is built on past events which are not available.
- it is complex and difficult to understand and fully appreciate by the members and probably by at least some members of the Board of Trustees.

#### *4.2.1.6 Time Horizon*

It is recognized that a going concern is based on the employer remaining in business on an ongoing basis for many years. Being able to utilize this condition does not determine the real liability of the plan in the event the employer enters CCAA/BIA, and the liability of the TBP on wind up is fully unknown. There needs to be a legislated requirement that an actuarial solvency for wind up be made available on a quarterly basis to the Board of Trustees so that they may have foresight on necessary financial strategies on which the TBP may continue to be effective. The impact of global financial events which occur without notice must be responded to by the Board of Trustees as rapidly as is feasible.

#### *4.2.2 Proposed Approach*

We support the mandatory establishment of a funding policy and the filing of the funding policy to the Superintendent. The funding policy, the funding deficit reduction policy and the surplus utilization policy are really all aspects of funding, and could and probably should be combined into a single policy.

The variability of the TBP is one of the issues which prevent establishing a fixed approach to calculate a funding ratio. This is exacerbated by the volatility of the market place. When defined benefit plans are converted, the entire amount of the defined benefit fund assets are assumed to be converted to TBP assets, and the defined benefit plan liabilities that were based on a solvency evaluation are recalibrated only to the amount required by the TBP on a going concern basis. Assuming there is full going concern funding on a conversion, employers and/or active employees would benefit from long term contribution holidays.

There therefore needs to be established a PfAD which prevents the distribution of or the use in contribution holidays of any surplus provided by the conversion, and a going forward PfAD attributable specifically to the active employee retirement target. The attributes of the PfAD need to be:

- Sufficient to meet world economic adverse deviations as measured by the last three economic down cycles,
- Sufficient to meet the economic fluctuations of individual industries, including effect of changes in legislation resulting in adverse financial impacts on employers and security.

- Sufficient to provide surety and security to retirees at the time of conversion
- Sufficient to protect the corpus of the defined benefit trust fund in the event of employer insolvency.

While, over decades, the DB Plan Benefits have been altered by events or contracts, nevertheless the benefits at these times have remained with the pension benefit contracted for both the retiree, spouse and should not be reduced to a second class benefit alterable or cancelable at will.

## Questions

- *Is the going concern valuation sufficient to measure and fund target benefits?*

The reduction of required funding is clearly the main reason employers would be interested in establishing a target benefit plan or converting a defined benefit plan to a target benefit plan. Funding on a going concern basis as proposed, even with a reasonable PfAD or other margin, provides a significantly lower level of benefit security than funding on a solvency basis, because of the concept used to measure “going concern solvency. Retirees on plan conversions cannot support this level of funding for a plan in which they remain members.

- *Which approach should be adopted under federal legislative and regulatory framework: the margin or the probability test? Is the PfAD approach appropriate as a funding margin or should a different margin calculation be provided for or allowed (e.g. through a discount rate margin)?*

We support the PfAD approach rather than a probability approach as it is more likely to be understood by plan members and for that matter, by the governance body.. The PfAD needs to be sufficiently robust to meet the requirements listed above. We understand the PfAD approach takes into account the demographics of membership in a particular plan, and the nature of the investments.

- *What is the appropriate time horizon for the purposes of calculating a PfAD?*

The time horizon for PfAD needs to be consistent with the time horizon for calculating the TBT. As events and economic issues warrant PfAD revisions, these may occur provided the listed requirements continue to be met (e.g. PfAD may need to be increased or, in some circumstances agreed by all stakeholders, decreased).

- *Should going concern valuations be required on a closed group or open group basis?*

We would tend to support the “open group” approach to funding on a going concern basis. We understand that whether this is appropriate depends on the particular circumstances of the plan and should be resolved through negotiations of the employer, employees and retirees.

- *How frequently should valuations be required?*

We would prefer that valuations occur quarterly so that remedial action, if necessary, can be taken swiftly.

- *Should some of the specifics on funding policy (e.g. PfAD rates) rely on guidance from source such as the Canadian Institute of Actuaries (CIA) or should they be more fully prescribed in legislation and regulations?*

The adjustment of PfAD will become reasonably complex. The Board of Trustees should have the best advice possible to make their determinations consistent with meeting the policy requirements for PfAD's of different corporations and industries.

### **4.3 Contributions**

Contributions need to be fairly and equally established through negotiations. Capping of either party's (employer, employee) contributions can lead to creating a prejudicial and biased opportunity for governance bodies controlled by employers to ensure any adverse deviation effects only accrue to the retirees. Hence detailed provisions as to deficit recovery measures must be in the plan text

#### **4.3.1 Considerations**

It is understood that under normal circumstances, contributions are generated by employers and employees. However, in current financial environments and rapidly altering employer circumstances, the current retirees will be affected for as long as they live. The input of retirees in the event of conversion is therefore a necessary element of TBP Plan development. Without the recourses available to employers and employees (e.g. both may find alternative financial opportunities to address their future requirements) who may agree to terminate contributions and recover any shortfall from decreased benefits, without legislative and plan protection, retirees are disadvantaged.

Variable contribution schedules may be preferable to address changing economic conditions or employer financial viability; however fixed contributions, as initially negotiated, provide certainty to all parties and necessitates that the governance body develop initiatives to maintain the plan sustainability. In any event, we concur with Government comments that benefit reductions should be a very last resort.

There exists a process (Section 4.11 Plan Termination and Wind Up) which resolves the issue of current retiree concerns, and that is to have the employer/sponsor of a defined benefit plan securitize and annuitize the existing retirees prior to terminating the defined benefit plan provisions and initiating a conversion from defined benefit to TBP. This process has the benefit of maintaining the livelihood for retirees prior to TBP, reducing the cost of the pension plan to the employer, and employing a fresh start principle. Should the Proposal in the Consultation Paper continue to advocate for termination and five year temporary solvency notional funding, then changes to the BIA/CCAA would be required to protect the solvency payments negotiated away during the five year period.

As confirmed in the Proposal, conversion to a TBP should not be an encouragement for an employer to apply for BIA/CCAA protection.

#### **4.3.2 Proposed Approach**

It would appear that variability by all parties will be required if the concept of TBP is to be achieved since the basic premise of a target benefit plan is variable. This does, however, reduce the responsibility of the Administrator to take measures appropriate to the target, unless either positive or negative incentives are a condition to his function.

In terms of triggers, it must be emphasized these may differ depending on specifics of the plan text and the result of negotiations. However:

- Establishment of the requirement for contributions should commence when the plan's assets go below going concern liability calculations and the agreed PfAD.
- There should never be a contribution holiday unless by consent of all stakeholders.

The contribution process needs to have minimum contribution level required by legislation as well as a minimum target benefit to qualify as a TBP. We are in agreement with the proposed plan text requirements.

## Questions

- *Is this approach to contributions to a federally-regulated plan appropriate?*

We would prefer some variability in employer as well as employer contributions in order to keep the employer committed to the administration and appropriate investments of the plan. Ceilings on the increases for both employer and members are appropriate, as are triggers for increasing (or decreasing) contributions. The foregoing, however, are matters for negotiation between the employer and plan members. Retirees would not be subject to contribution increase; they would however be affected by benefit reductions in lieu of contribution increases, but since the resolution of this issue effects significantly the benefit status, they need a voice in the actions implemented.

- *Should some of the specifics concerning contributions be determined by plan members or more fully prescribed in legislation or regulations?*

We believe that contribution levels and variability be included in the plan text which is negotiated by all stakeholders along with triggers set out in the funding policy that will be submitted to the OSFI Superintendent and attached as a schedule to the plan text.

## 4.4 Benefit Structure

Since the current and future retirees are key stakeholders, it is prejudicial to exclude them from participation in determination of benefit structure. It is also necessary to reduce some of the complexity in the proposal to maintain as few classes of benefits as possible or to view any as having greater status than any other (e.g. retiree, spouse of retiree, indexation, health and welfare, insurance). Specifically, the classes of benefits need to be agreed by negotiation of stakeholders.

### 4.4.1 Considerations

#### 4.4.1.1 Adapts to Market Conditions

Should conversion from defined benefit plans to TB plans remain in the proposal for existing retirees, the fundamental cornerstone of the defined benefit plan (risk belongs to the employer) is to be replaced by “risk belongs to the retiree”. In this reversal of existing PBSA legislation, there is an imposition on senior citizens of a new model pension plan, which they:

- Did not contract for when employed
- Are not aware of the changes in fundamentals
- Are unable to understand why the Government is permitting their pensions to be at risk

It may be worthwhile to note the objective of pension plans is to provide, with some certainty, a portion of an employee’s remuneration towards the security of their retirement years. TBPs changes the objective of pension plans as originally conceived over fifty years ago.

#### 4.4.1.2 Security of Benefits

While, over decades, the defined benefit plan benefits have been altered by events or contracts, nevertheless the benefits at these times have remained with the pension benefit contracted for both the retiree, the retiree’s spouse, and should not be reduced to a second class benefit alterable or cancellable at will.

While classes of benefits may provide facility to allocate available pension funds, it also may allow a discriminatory situation, in a complex environment which can only result in legal contentions and failure of the plan structure. It is critical that benefits classes (basic, medical, spousal, etc.) be treated equally, as they were earned equally, unless by consent of stakeholders, there is reason to make some adjustments..

#### *4.4.1.3 Categorization of Benefits*

Should categorization be found acceptable by the stakeholders, then for the base classification, the highest level of pension security feasible is appropriate. Benefits for retirees should acquire the status of secured creditors in insolvency. Lenders and creditors who take advantage of the lower funding requirements of TBPs to increase their own security should be prepared to recognize the risk to retirees.

It would be useful for the federal legislative TBP framework to specify the benefits per class and make appropriate revisions to insolvency legislation so as to insure consistency in the laws.

#### *4.4.2 Proposed Approach*

Should the two tier framework be applied, then as a result of the reduced contributions inherent in such a classification increased protection for the base benefits class should be recognized in the event of insolvency. The creditor status requires revision to be higher than those investors, lenders, bondholders who understand their level of risk. The pensioners, however, did not accept such risk when they committed to pay for their pensions with a portion of their wages.

The full implication of the approach will be dependent on an acceptable definition of last resort. While the proposal suggests an infinite amount of flexibility, it also must consider the unanticipated consequences of such allowances, and the extent to which a plan may be placed at further risk.

#### **Questions**

- *Is the approach of categorizing benefits in two classes appropriate?*

Not for retirees. All pensions were earned with all classes as referenced, included and paid by the retiree. There should be no discrimination in a retroactive manner. If, however, there is a negotiated agreement that an element of a pension may be diminished without affecting the core pension, it may be listed in the text of the plan.

- *Should base and ancillary benefits be determined by pension plans or more fully prescribed in federal legislation or regulations?*

If created, they should be determined on a plan basis, agreed to by the active employees and retirees as individual groups on a conversion, and set out in the plan text.

## **4.5 Detailed Commentary**

### ***4.5.1 Funding Deficit Recovery Plan***

The statement that plan members and beneficiaries would also have a responsibility to fund deficits is not accurate. Employers desire to have a known amount of contribution. In a TBP members and beneficiaries will then have the sole responsibility of funding the deficit by increased contributions or reduced benefits. That, after all, is the point of TBPs from the perspective of the employer.

### ***4.5.2 Considerations***

#### ***4.5.2.1 Change in the Plan's Financial Position***

The emphasis of the consultation Paper is on the sustainability of the plan, to the detriment of other stated purpose of benefit security.

A TBP transfers the risks and uncertainty arising from the volatility in the markets and interest rates from the employer directly to the plan members and beneficiaries. AS we have stated, the purpose of a pension plan is to provide pensions. There is little point in the sustainability of a plan that cannot do so. Moreover, employees will plan on the basis of target benefit, whatever they are told about the uncertainty of the benefits. Frequent changes in the benefit and contribution structure will lead to uncertainty and anxiety. The way to deal with underfunded plans is to amend the plan for future accruals, and to provide regulatory funding relief.

#### ***4.5.2.2 Consistency with the Funding Requirements, Benefits and Contribution Models***

It is quite clear that employer contributions will be fixed, or capped within a narrow window, and that the funding deficit recovery burden will fall on the members. There will be a range of member contributions, and these will undoubtedly be capped. Benefit reductions would be inevitable.

Without legislative protection, and weighted voting on the Board of Trustees, we do not believe that benefit reductions for retirees will be or can be protected in models of deficit recovery measures. Retirees simply do not have the negotiating power of active members and the employer. As to whether retirees should be protected as a matter of equity as between the active members and retirees and near retirees, please refer to our introductory comments.

As to whether the trigger for taking action is a going concern ratio including the PfAD, or the going concern ratio and the "probability test", neither assures benefit security. We favor simplicity and comprehensibility, which would lean towards the PfAD margin.

There must be an initial actuarial determination of the level of contributions necessary to ensure that the funding threshold will be reached to ensure the target benefits

#### *4.5.2.3 Impact on parties*

Given the inevitable conflict between active members and retirees in respect to benefit reductions, and the vulnerability of the retirees as compared to the active members and the employer, even if retirees are represented on the Board of Trustees, governance body benefit reductions cannot be left up to the Board of Trustees, even with weighted voting. . Priorities must be set out in the plan document and retirees given protection in the legislation.

### **4.5.3 Proposed Approach**

#### *4.5.3.1 Deficit Recovery Plan*

There must of course be a detailed deficit plan. The priorities should be set out in the main plan text; the trigger, timelines, minimum funding level and approval process in a funding recovery plan attached to the plan as a Schedule. As noted earlier, retirees will not be in a strong negotiating position on a conversion. Nor would they be in an effective position in any approval process unless there is a requirement for affirmative consent. Hence legislative protection for retiree benefits is required.

#### *4.5.3.2 Liability*

It is misleading to suggest in the Consultation Paper that the employer will have any responsibility for the deficit if the employer's contributions are fixed or fixed within a narrow window.

#### *4.5.3.3 Trigger*

Again, we point out the uncertainty and anxiety and fundamental unfairness of benefit reductions that might take place from time to time, to retirees on conversions, retirees who have responsibly planned their retirements on the basis of promised defined benefits. The more often measures must be taken under a deficit recovery plan, the more uncertainty and anxiety will result.

Legislation must require a conservative actuarial approach and PfAD or other margin to minimize the possibility that funding deficit recovery measures are required.

#### *4.5.3.4 Timeline*

Please note our comments on the uncertainty and anxiety from benefit reductions if such are applicable to retirees. Legislation should ensure that they will not be applicable to retirees.

We believe a three year period is the appropriate timeline for such measures. Interest rates and investment performance can vary considerably within a one year time frame.

#### *4.5.3.5 Deficit Recovery Measures*

We are encouraged to see that employer contributions are suggested as a measure to be taken as a deficit recovery measure; however, we doubt that employers will agree. The point of a TBP is to limit an employer's risk and to transfer risk to the plan members and beneficiaries.

We are not sure what is contemplated by the reference to plan termination in the fifth bullet.

#### *4.5.3.6 Process*

As noted above, the deficit recovery measures must be very detailed and set out in the plan text and funding recovery plan and legislation must provide for the protection of retirees. The voice of the retirees on the Board of Trustees will not prevail unless there is weighted voting.

### **Questions**

- ***Should the deficit recovery measures and their prioritization be determined by plan members or more fully prescribed in federal legislation or regulations? If the latter, what measures should be prescribed and what should be their order of priority?***

When a TBP is the result of a conversion of an existing defined benefit plan, retiree and near retiree basic benefits should be protected by legislation. Otherwise, deficit recovery measures should not be prescribed by legislation in detail, as they should be appropriate to the benefits under the plan and the demographics. They should however be set out in the plan text in detail. We suggest that it would be useful for OSFI to set out principles for such a policy in Guidelines. Basic concepts could be set out; i.e. there could be a legislative definition of base benefits and a requirement that these not be reduced until other deficit reduction measures have been unsuccessful.

- ***Should deficit recovery measure be triggered as soon as the PfAD starts to be depleted or the probability test not met?***

First, we believe that deficit recovery measures should not include a reduction of retiree benefits. If, however, benefits are reduced, we are concerned with the anxiety and uncertainty that would result from a frequent adjustment of benefits. We believe a three year period is appropriate for action to be taken, with adequate communication to plan members. Much can happen to investment performance and interest rates in a shorter

time frame, and it is not in the interests of any of the stakeholders to make changes that will be reversed or exacerbated shortly afterwards.

As noted above, legislation should require conservative actuarial assumptions and a conservative PfAD or other margin to minimize the possibility that deficit recovery measures will be needed.

## **4.6 Funding Surplus Utilization Plan**

A surplus is defined in the PBSA when the excess value of plan assets over the liabilities of the plan as measured actuarially exceeds 105%. The abolishment of solvency funding significantly decreases the liabilities when measured on a going concern basis. The policy on this issue should recognize policy set for under a deficit situation. Consistency in policy setting to insure it is not asymmetrical, particularly for retirees, is critical.

### **4.6.1 Considerations**

#### *4.6.1.1 Change in Plans Financial Positions*

For some time, and apparently continuing, the volatility of conditions has impacted financial markets and pension asset accretion. However, in a representative number of cases (Nortel, Stelco, AVEOS), this is not the case. Accepting these circumstances and the fact that going concern liabilities are in no way indicative of the true solvency and security of a defined benefit plan in wind up, it is necessary that any minimum margin proposed for a TBP be at least equivalent to that of actuarially measured solvency liabilities.

#### *4.6.1.2 Consistency with the Funding Policy, Benefits and Contributions Model*

We agree that surplus utilization provisions should be consistent with funding policy. However, until consistency in the values established for full funding plus that required by the PfAD liabilities are covered, there should be no surplus distribution. However, even in this case, because of historical experience with employer contributions holidays, this should not be allowed at least until the solvency requirements measured on an actuarial solvency basis including that currently defined by the PBSA is achieved.

In any event, in order to avoid an asymmetrical risk issue, surplus would be applied to rectify any pension reductions experienced by retirees, who have no other recourse to rectify their losses.

#### *4.6.1.3 Entitlement*

We are in agreement with the proposal, which needs to conclude that the allocation is on an initial priority basis to retirees/pensioners whose losses directly impacted their livelihood whereas any losses to employers and employees were rectifiable in the future.

#### *4.6.1.4 Surplus Available for Use*

Essentially, because of the volatility of the elements affecting accrual or loss to plans assets over the operating life of the TBP on a going concern, any surplus should be applied to rectification of any losses attributable to the employee, retiree/pensioner, and

any remaining surplus after continuing to satisfy the PfAD requirements, continue to be applied to fund growth. Any other consideration of surplus will be counterproductive to plan sustainability and member/retiree security. Should legislation not be provided in accordance with the above, then limits should be set such that during the period over which the definition of “going concern” is set that any reduction in target benefit not be feasible.

#### *4.6.1.5 Impact on Parties and Equity*

In order to assure a fair and equitable utilization of surplus, a requirement that the utilization be dedicated to fund sustainability and growth is appropriate. As indicated, the example used by the proposal will most likely not be fair to all parties. It is also appropriate that surplus’ not be shared with the employer unless they have made additional contributions to their fixed contributions.

#### *4.6.1.6 Level of Prescription*

The parties to the plan policy and text will have varying objectives and agendas. Concurrently, it is also recognized that the employer and employee have generally been more successful in presenting a favourable case to the legislative organizations. As mentioned previously, retirees are generally ill-funded, lack adequate knowledge and do not act as cohesive organizations and hence are at a disadvantage in providing a timely insightful position. Legislation, if provided, would emphasize the full requirements to achieve fairness to those who will generally be most at risk.

#### *4.6.1.7 Ongoing versus Terminated Plans*

We agree

### **4.6.2 Proposed Approach**

#### *4.6.2.1 Surplus Utilization Plan*

The development of detailed rules and provisions for a TBP should also examine pension plan historical records. To our knowledge, only one plan possesses sufficient longevity to provide meaningful guidance in attempting to allocate surplus utilization..

Surpluses are as volatile as the environment in which they occur. Over time, few have been able to predict economic boom or bust periods. Attempting to create a formula to protect plan assets against such adverse deviations is indeed a very impressive science bordering on an art form. TBP’s, similar to other pension plans, need to be created for positive long term sustainability, spending (e.g. utilizing) surpluses, even with buffers, increases the risk of not achieving the target and of maintaining sustainability. Existing retirees should not be exposed to such risks, particularly as it was opposite to their hiring agreement.

#### 4.6.2.2 Entitlement

Legislation needs to at least cover the apportionment triggers for identical plan categories, if they exist, which we would not suggest.

#### 4.6.2.3 Surplus Utilization Trigger

While we do suggest there should not be any utilization triggers as long as current defined benefit plan retirees are in existence, there should be utilization triggers on a going forward basis for new TBP members. The following might be considered by the governance body or in a surplus utilization policy: Surplus may be used provided the plans assets exceed its going concern liabilities by: the difference between the solvency liability and the going concern liability plus the PfAD. The priority of surplus utilization is as above.

#### 4.6.2.4 Calculation for Surplus Available for Use

There would be great specificity required to establish an amount of surplus available, and the attainment of any such amount fraught with opinion. It is a reason for recommending that no utilization of surplus, even if identified and agreed by all stakeholders, as the passage of time (as required by pension plans) may negate any such identification.

To the extent possible, any such calculations would require participation by current defined benefit retirees as these would immediately become the group at risk.

#### 4.6.2.5 Surplus Utilization Actions

The proposed listing of actions is commendable, however, in addition, to ensure such actions are possible under all employer status, revisions to the BIA/CCAA will be required to reflect secured creditor status based on the increased risk assigned to the beneficiaries.

There are consequences of penalizing intergenerational pensions (e.g. those whose benefits were increased or decreased over the periods involved versus those who were not).

The notion of “Temporary” improvements to ancillary benefits implies the possibility of inability to maintain surplus.

### Questions

- ***Should the surplus utilization measures and their prioritization be determined by plan members or more fully prescribed in legislation or regulations? If the latter, what measures should be taken and what should their order of priority be?***

There should not be pension holidays or changes to contributions until such time as any defined benefit retirees and their beneficiaries remain in the plan . On a going forward basis for all new TBP members, regulations and legislation should prohibit surplus disposal and utilization.

The priority should be to compensate to the extent possible any measures that had been taken to increase contributions or reduce benefits to deal with a funding deficit. A surplus utilization plan should be one of the cornerstone documents of the plan, along with the plan text, the funding policy and the deficit recovery policy, all of which are logically aspects of the funding policy. This cannot easily be prescribed, but we suggest that OSFI issue Guidelines with respect to a surplus utilization policy in target benefit plans that would set out this minimum standard as a duty of the administrator.

- ***What would be an appropriate margin (over the fully-funded level) going concern solvency level to allow surplus utilization? What would be an appropriate cap on the utilization of surplus?***

This question is covered by Sections 4.6.2, 4.6.3 and 4.6.4.

## **4.7 Disclosure and Communications**

Consistent with the referenced legislation, it is also critical to note that the accrued benefits of a defined benefit member can only be transferred to a TBP with the consent of that plan member or retired member.

### ***4.7.1 Consideration***

It is critical for all retired DB Plan members to understand the fundamental change being mandated. They must be provided with and able to signify appropriately their understanding of the parameters of the plan. They should also have explained, in sufficient detail, the differences between their existing DB Plan and the TB Plan.

It should be the duty of the employer, in concert with representatives of the defined benefit retired members, to ensure that the required level of understanding and awareness is achieved prior to requesting their (retired members) consent to conversion.

### ***4.7.2 Proposed Approach***

Attempting to develop a comprehensive and acceptable information system, to ensure fairness, compliance with the Canadian Bill of Rights will be a daunting task. Its complexity should be set out as plainly as possible with summaries covering each aspect that is easily understood by retired plan members. It should not be left solely to lawyers, actuaries or the employer's human resources department. The Board of Trustees must take responsibility for the disclosure, and the legislation should ensure that all of the information meets all legislative requirements. When retirees do have representative associations available, those groups should participate in developing and communicating the essential of the TBP proposals.

Pionairs are in agreement with the totality of the information identified in the consultation as required both for OSFI and the plan retired members. The regulations need to specify the information will be provided in a timely manner (90 days) and sufficiently in advance of any decision being required so that the retired member may seek adequate information to permit an informed decision.

We would continue to emphasize that only one level of benefits should be specified for retirees and thus the annual statements should focus on that level without the complexities of additional levels or the questions arising as a result of potential interaction.

While the sponsors and employees do have funding available to obtain advice and counsel on individual issues, retiree members do not. Legislation should include a funding method by which retiree members or their representatives may obtain sufficient

funds to obtain equivalent levels of advice and counsel as the employer and the employee.

## Questions

- ***What are your views on the proposed additional disclosure requirements listed above?***

Provided all documents are identified, then the documents which require more frequent issuing should be made available. For instance, if a plan is below target, the members will wish to know the recovery plan and the performance of the plan

- ***What are your views on the timing, frequency, and sequence for communicating these additional disclosure items?***

The governance body must provide, on a quarterly basis a solvency valuation so that the retired members have a source of information pertinent to their plan performance. In times of positive and negative economic cycles the plan member must be concerned with the possibility that the target benefit will not be delivered should the employer enter BIA/CCAA and the attendant risk of plan wind up. To properly assess the possible risks without understanding the solvency valuation for retired members requires significant professional assistance and knowledge of plan financial status. Transparency of plan funding on wind up will prevent marginalization of the member and diminish their lack of comprehension of plan risks.

- ***What are your views on requiring the plan administrator to report the solvency funding ratio of the plan in its annual reports for informational purposes only?***

The Pionairs agree that all of the disclosure items identified in the proposal should be provided to all members in a form from which they can readily understand the issues. Further, the information needs to be supplied in a timely manner to retired members and their representatives. These disclosures also require solvency evaluations and plan recovery schemes. These documents could form part of a Master Disclosure Document, of which some sections covering volatile issues are made available with greater frequency.

## **4.8 Conversion of Pension Plans to Target Benefit Plans**

The initial sections of response to the Request for Consultation outlined the currently available Pension Plans Regulated by the Federal Government. In the opinion of the Pionairs, as described above, there are sufficient options presently available to meet the objectives stated in the proposal:

- Assure sustainability of Private Pension Plans
- Provide relief to Employer Pension Funding liabilities.

### ***4.8.1 Considerations***

Giving consideration to converting existing retiree members of defined benefit plans to TBPs is counter to Canadian long held social tenets as to fair and equitable treatment of Canadians..

### ***4.8.2 Funding Deficits on Conversion***

We believe that there should be full funding on a going concern basis plus PfAD. However, conversion of defined benefit to TB Plans should not be an issue as even insolvent DB Plans generally have significantly greater assets than those required to meet full TBP funding requirements including PfAD. The issue becomes what disposing of the remaining DB assets will do to the Government mandate. In some instances the surplus available could permit contribution holidays for a long time.

### ***4.8.3 Accrued Benefits***

Unless the existing DB Plans are allowed to continue, the gradual depletion of those plans' assets will only serve to increase pensioner risk in an insolvency situation. At a minimum the federal Government should:

- a) Require that all existing individuals and their spouses have their accrued benefits fully securitized
- b) Require changes to the BIA/CCAA such that in the event of employer insolvency the pension amounts due to beneficiaries of a DB Plan measured on an actuarial solvency basis be considered to have a fully secured creditor status.

Additionally, should a DB Plan retired member choose to convert to a TB Plan, then it should only be done after his individual full and knowledgeable consent .

### ***4.8.4 Proposed Approach***

The conversion of defined benefit plans is fundamentally unfair to retirees, and for that matter, to near retirees. Elderly, senior individuals spent a lifetime earning and paying for a pension which is subject to reduction, quite apart from the adverse effect of

inflation. Accordingly the approach must also include agreement by each individual having been fully informed of the issue and acknowledging his/her understanding.

- ***What are your views on how benefits are treated upon conversion?***

Since a conversion prejudices retirees, with little or no hope off any benefit, the preferred treatment of retirees is to securitize their pensions with the purchase of fully funded annuities covering their individual full pension lifetime requirements, with the cost topped up by the employer.

This has a significant benefit to the employers:

- Because it removes a major liability from their financial account
- They no longer are required to make current or part payments to the defined benefit pension plan.

We believe, that a going concern deficit should be fully funded only on a going forward basis and introduced to new employees, while current active employees be given an option to join the TBP or not. Retired members remain in the registered defined benefit plan until their death (if they are not annuitized upon conversion.) If this cannot be done, recourse should be made to the distressed plan workout scheme, and the TBP proposal abandoned, in regard to existing DB plan retirees.

- ***Do you have any other views on how accrued benefits should be calculated at the time of conversion?***

Our opinion is that the TB Proposal should be abandoned as applicable to current DB plan retired members and DB accrued benefits be paid in accordance with PBSA Legislation.

- ***What views, if any, do you have on converting federally-regulated DC plans to TBP's?***

Our opinion is that the existing DB plan retirees should be exempted from the TBP proposal and plan sponsors either continue to fund the DB plan as per their promise and contract or securitize the plan.

## **4.9 Portability and Locking-in Rules**

Inasmuch as this commentary is focused on issues relating to retired defined benefit plan members, the current regulations should remain applicable as they were the regulations in force and accepted by the retired pension plan member at time of retirement.

### ***4.9.2 Proposed Approach***

We believe there should be optional portability permitted upon retirement, or termination of employment, based on going concern transfer ratios. Retirees and deferred vested members should have the additional opportunity every 5 years to transfer the commuted value of their benefits out of the plan. This permits security of benefits if the plan's funded ratio improves.

### **Questions**

- ***Are there any TBP-specific issues in relation to locking-in and portability that should be addressed in the federal legislative and regulatory framework?***

The locking-in and portability options should be consistent with those in the PBSA. However, we believe that the purchase of annuities should be permitted upon retirement, for several years after a conversion to protect active members near retirement. An annuity purchase in good faith and with due diligence should relieve the plan, the plan administrator and the employer of further liability to the member.

#### **4.10 Individual Termination**

We do not believe this issue is applicable to retiree members; however our following comments may be of assistance.

On termination of employment (prior to age 55 or otherwise as the plan and the legislation permit) individuals have the choice of a transfer of the commuted value of their accrued pensions to a locked-in RRSP or to a life insurance company for the purchase of a life annuity or waiting to receive a deferred pension from the plan. It is our position that individuals who elect a transfer to an RRSP or to purchase an annuity upon termination should not be in a more securely funded position than the remaining members in the plan. They have chosen not to share in the risks of the plan which is their right; they should not pre-empt or share in the rewards, including a share of any buffer margin or surplus.

However, individuals who elect to leave their pensions in the plan, because the plan is underfunded and they will not receive the full value of their accrued pensions should have periodic (every 2 or every 5 years) opportunities to take the commuted value as determined above, so that if the plan becomes fully funded, they will not have been prejudiced. Moreover, they may benefit from a surplus allocation.

#### **Questions**

- **What are your views on the methodology used to calculate the individual termination value?**

TBP plans are collective plans built over time from employer, employee contributions and investment returns. Retired members contribute pension reductions, any surplus should therefore, as previously mentioned, remain in the plan to the benefit of all members. A member terminating should be entitled to only the TBP benefits appropriate as time of termination.

In the event the plan, on termination, is in a deficit, then he/she should only receive the amount identified in the proposal, except he/she should never receive any amounts available to plan surplus since these amounts are required for plan sustainability. It is only appropriate that an individual terminating should not receive benefits while worsening the funding for all members.

## **4.11 Plan Termination and Wind-Up**

In recent times plan wind ups have, on occasion, taken inordinate periods of time resulting in significant diminution in assets and possible increases in liabilities

### ***4.11.1 Considerations***

There is a need in any plan wind up that it be accomplished expeditiously so as to preserve the plan assets without extensive reductions due to litigation or other expenses attributed to the plan which reduces its available assets for distribution to the members.

The logic of using going concern for evaluation is understandable; however, at wind up the actual solvency deficiency is the measure which satisfies reality. The fact that the assets are significantly underfunded is the result of the TBP plan objective which was presumably approved by the members. It is required that the assets be protected to a much greater degree than the deemed trust noted in the PBSA and made unenforceable by the Courts in the AVEOS CCAA. Both the BIA/CCAA need to be revised to permit some employee asset recovery and to respond to the possibility of reduced sums being available as a result of using a “going concern” funding proposal.

We do agree with installation of the five year rule on termination, however, the premise used in the proposal is mostly fictitious as any employer seeking to reduce costs will terminate, apply for a TBP and plead nonpayment of termination as required for sustainability. There needs to be effective methods of legislative enforcement if this concept is to be operable.

### ***4.11.2 Proposed Approach***

The approach lacks credibility since the calculation falls far short of the calculation required by a DB Plan on termination.

### ***4.11.3 Termination Value***

Termination values may well vary depending on the situation. If it is a voluntary termination, the proposal would be adequate provided all contributions due but not paid are paid, have effective secured creditor status. This should permit an early wind up even though the pension contracted by DB Plan retirees may well be significantly reduced. Incidentally, all termination costs need to be to the employers account.

If termination is involuntary, most likely due to employer entry into BAI/CCAA, having noted that the deemed trust created by the BPSA has been rendered inoperative by the courts, legislative change needs to be made to the BIA/CCAA so that sums due to the pension fund by the employer are consistent with pension legislation.

#### ***4.11.4 Termination and Wind-up following Conversion from a DB Plan***

We are in accord with the proposal, however, the issue remains that the TBP Plan results in reduced amounts during the five year period, and due to insolvency, reduced employer's contributions have occurred and will continue due to the insolvency.

#### ***4.11.5 Declaration of Termination***

No comment.

#### **Questions**

- ***What are your views on the formula used for calculating termination value? Would it be more appropriate to use the solvency funding ratio?***

Termination using a solvency ratio is appropriate.

- ***What are your views on applying solvency requirements in the case of plan termination with five years of conversion from a federally-regulated DB plan?***

The employer should retain the obligation to fund the plan on termination on the basis of the contributions that would have been required had there been no conversion. This is in accordance with current PBSA requirements which were legislated in 2010 and regulated in 2011. Revisions to other legislation such as BIA/CCAA will be needed to assure the employer complies with these requirements.

## CONCLUSIONS

From the position of retired pension plan members, there does not appear to be a requirement for any additional plans in order to comply with the proposals in this document.

The proposals call for retiree participation in the conversion development of plan text revisions to the plan and in the decisions as to whether to increase in contributions/reduction of benefits. We believe that such participation cannot adequately protect retirees. In effect, the proposed legislation makes retirees, the most vulnerable and least of all the pension stakeholders to protect themselves, for protecting themselves.

If the legislation is proceeded with, retirees need to be given the following protections:

First and foremost, for plan conversions from existing defined benefit plans to be approved, we believe it is appropriate for the affirmative consent by member groups, the actives, the individual retired member or retired member representative, to be required. A plan conversion is similar to a surplus distribution, but with far more serious consequences to the members. Accordingly the level of member consent should be set at 50% +/- of the members of each group and then, if approved, by individual retiree member consent prior to this/her conversion from a DB to a TBP Plan.

Alternatively, and preferably, the conversion should allow for the purchase of annuities for retirees to remove them from the risks of the plan.

Further Protections:

- Information and education both as to conversions if proposed and as part of the plan governance.
- Funding for organization and participation in discussions and negotiations re conversions and responses to insufficient funding. Funding should be from the employer, not the plan. Representatives of retirees will have to be appointed, if they are not organized at the time of the negotiations and access to contact information of members provided.
- Legal and actuarial support again paid for by the employer, not out of the plan.
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In effect, the proposed legislation makes retirees, the most vulnerable and the least able of all the pension stakeholders to protect themselves, responsible for protecting themselves