POSITION OF THE PUBLIC SERVICE ALLIANCE OF CANADA IN REGARD TO A CONSULTATION PAPER FROM THE DEPARTMENT OF FINANCE TITLED 'PENSION INNOVATION FOR CANADIANS: THE TARGET BENEFIT PLAN'

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POSITION OF THE PUBLIC SERVICE ALLIANCE OF CANADA

I. THE PUBLIC SERVICE ALLIANCE OF CANADA (THE "PSAC")

The PSAC represents 150,000 members who work in 215 bargaining units in the federal sector. PSAC members work directly for the Government of Canada, and also work for federal Crown Corporations and other employers that are subject to the federal Pension Benefits Standards Act and could be affected by the proposals set out in the consultation paper. Also of particular concern is that these changes could be used a template to erode the superannuation benefits that provide stable retirement income for federal government workers.

II. INTRODUCTION

The discussion paper addresses the wrong problem, in the wrong ways.

It contemplates replacing secure and predictable 'defined benefit' retirement plans with 'target benefits', i.e. benefits that can be cut. Members' retirement income security would fall under the proposed target plan, and so would their quality of life.

Replacing secure and predictable 'defined benefit' pensions with pensions that are 'target' and may be reduced at any time – including in retirement – is a mistake.

Canadians require decent pensions upon which they can rely – pensions that are secure and predictable, and that allow them to plan their retirements within the budgets their pensions allow. Not knowing how much a pension will be next week or next year undermines the retiree's security in retirement, compromises the retiree's quality of life and weakens the retiree's ability to participate in their community and support their local economy.

Predictable and secure pensions are not the problem

The real pension problem is that 2/3 of Canadians have no workplace pension at all. They rely on the too-low Canada Pension Plan and a hodgepodge of high-fee, finance industry friendly private retirement savings plans that are inadequate to the task of real retirement savings.

The real solution to the real pension problem is to improve the CPP for all Canadians. The Government of Canada is the chief obstacle to solving this real problem. It single-handedly vetoed, at the December 2013 Finance Ministers meeting, a broad national consensus to move forward with CPP reform. This left Canadians in the lurch, heading towards insecure and unpredictable retirements with inadequate retirement incomes.

It is particularly disappointing that, not content to veto a real solution to a real problem, the Government of Canada seems intent on undermining the very basis for retirement income security in Canadian workplace pension plans. Target benefit plans do not provide the platform Canadian employees need for their retirements; target plans will become part of a growing retirement income problem in Canada, and will form no part of its solution.

III. THE PURPOSES OF PENSION PLANS

Pension legislation often invites us to “get into the weeds” and consider narrow albeit important issues.

But the changes proposed in the discussion paper are profound. They do not make simple adjustments, or improve the drafting of one or another legislative provision. Rather, they reframe the nature of the pension promise that employers make to their employees and retirees, and this will have profound impacts on those employees, their families and Canada’s economy.

The basic purpose of a pension plan is to provide decent retirement incomes that are secure and predictable. The promise of a pension is essential to attracting and retaining employees in an economy that is strong and competitive, and where private sector wages continue to outpace public sector wages.

Decent, secure and predictable pensions give their recipients ‘pension confidence’. Pension confidence means that people, while they work, can spend their earnings, knowing that their retirement days are secure. As important, pension confidence also means that retirees can spend each pension cheque, knowing with confidence that their income stream is not in doubt. Pension confidence underpins the economies of many small communities with significant pensioner populations and the small businesses that serve them.

The real problem in the pension sector is the number of people who do not participate in decent pension plans. In some cases, employees without pension plans earn incomes that allow them to save for retirement, but the savings mechanisms available to them from financial institutions are typically expensive and inefficient in comparison to large scale pension plans. In other cases, a decent pension plan is the crucial bridge that could allow modest income earners to save enough for a decent retirement. In all cases, the lack of pension coverage across Canada hurts the country, and hurts its regions.

Looking forward, for example, Professor Michael Wolfson projects that half of Canada’s middle income earners will experience a significant decline in their standard of living standards after retirement. In his paper, “Projecting the Adequacy of Canadians’ Retirement Incomes’, published by the Institute for Research on Public Policy in April 2011, Professor Wolfson concluded that “…roughly half of Canadians born before 1970 who had mid-level earnings in their pre-retirement years will face declines of at least 25 percent in their living standards (i.e., consumption possibilities) post-retirement.” These findings have been confirmed in other studies of income replacement prospects for Canadians[i]. This failure is largely owing to the inadequacy of pension coverage in Canada. This is the real problem that presses for solution.

Unfortunately, the discussion paper does not address the fundamental problem of pension coverage. Employers will not establish new target benefit plans where no plan currently exists, and they will not convert existing defined contribution plans to target plans. There has been no cry from employers for target plans to improve coverage. Rather, employers will use any target benefit plan provisions to convert good defined benefit plans that provide decent, secure and predictable benefits, into the much less secure form of target benefits. No such conversions should be permitted; good pension plans should be preserved and expanded, not downgraded.

Unfortunately, the discussion paper takes a narrow and punitive approach to those with existing pension plans. It sets the stage for a downgrade of those plans, and a reduction of benefits to members.

Within the sphere of workplace pension plans, Canada's experience has led the world – not in the direction of 'target' plans, but rather towards 'jointly sponsored plans' that provide secure and predictable defined benefit style benefits.

IV. THE CANADIAN JOINTLY SPONSORED DEFINED BENEFIT PENSION MODEL

A. The Most Successful Pension Model in Canada

Canada has been a world leader in pension innovation. Pension boards, including the Ontario Teachers' Pension Plan Board ("OTPPB") and the Hospitals of Ontario Pension Plan ("HOOPP") are often cited examples of leadership in pension management and investment. The OTPP and HOOPP, along with the British Columbia Municipal Employees' Pension Plan, the British Columbia Public Service Pension Plan, the British Columbia Teachers' Pension Plan, the British Columbia College Pension Plan, the Ontario Municipal Employees' Retirement System, the Colleges of Applied Arts and Technologies Pension Plan and many others, are successful examples of a pension governance model pioneered in Canada, and now known as the "jointly sponsored defined benefit plan" (the "JSDBP") model.

PSAC members already participate in many provincially regulated JSDBPs. PSAC members belong to a number of JSDBPs, including OMERS (covering PSAC members at the Windsor, Timmins and North Bay Airports, the Port of Prescott, and Town of Moosonee), the BC Municipal Plan (covering PSAC members at Victoria Airport and BC First National Health Authority) and HOOPP (covering PSAC members at the Weeneebayko Health Authority).

The JSDBP model first emerged in the 1990s. Prior to its introduction, employers were responsible for funding the full cost of the pension plan less any amounts contributed by a plan's members. In general, this meant that employers carried more risk than employees since employers were responsible for the full balance of cost of the plan. Under this model, employers also had significant advantages – many used plan surpluses to reduce their contribution levels below the rates paid by their employees.

B. How the JSDBP Model Works

The JSDBP model rejected the premise that the employer was ultimately responsible for funding the full costs of benefits less employee contributions. Instead, the new model proposed a sharing of all plan costs, including deficit funding costs. As important, JSDBPs also share any plan surpluses between employees and the employer.

In general, this means that JSDBPs' current service costs (i.e. the cost for service accruing in the current year) are shared between the employer and the employees. In addition, if a deficiency emerges in a JSDBP, the contributions necessary to pay down that deficiency are also shared between the employer and its employees. On the other hand, and as a *quid pro quo*, where the plan experiences a surplus, that surplus is also shared between the employer and the employees.

Because costs, risks and surpluses are shared in a JSDBP, governance is also shared. Both employees and employers bear the cost consequences of pension design decisions, and also of pension investment and administration decisions. Accordingly, both employers and employees jointly control the processes to make these decisions in a JSDBP.

C. JSDBPs Provide Secure and Predictable Benefits

It is key critical to spotlight that the JSDBP model did not change the nature of the pension promise, nor did it undermine confidence in the pension system. Under a JSDBP model, pensions are accrued with every year of service, and once accrued they cannot be reduced except in the extraordinary event of plan wind-up. JSDBPs provide decent, secure and predictable pensions and maintain pension confidence among their members – a confidence that is generally enhanced by the participation of their representatives in pension governance. JSDBPs have strengthened the pension system in Canada and continue to attract widespread support and approval from all over the world.

The federal Pension Benefits Standards Act does not currently accommodate JSDBPs, even though JSDBPs are the most successful form of pension plan in Canada.

It is also important to add that, while JSDBPs have been very successful, and their absence from the Pension Benefits Standards Act needs to be corrected, JSDBPs are not the appropriate pension model in all cases. Where adequate, secure and predictable benefits can be delivered through existing models, those models may well be preferable to JSDBPs.

V. THE PENSION BENEFITS STANDARDS ACT (PBSA) NEEDS REFORMS

The PBSA urgently needs reforms, though not 'target benefit plan' reforms.

First, the PBSA needs reforms to provide for JSDBPs that deliver secure and predictable pensions – not to permit employers to replace secure and predictable pensions with 'target' benefits.

(i) The PBSA Needs a JSDBP Regulatory Framework

Sensible JSDBP reforms would include the introduction of a JSDBP regulatory framework into the PBSA. Remarkably, the PBSA doesn’t even contain a definition of a JSDBP, much less a sensible regulatory framework for them. Existing pension legislation in Ontario, and about to be proclaimed legislation in British Columbia, Alberta and Nova Scotia all create a regulatory framework for jointly sponsored pension plans. The PSAC would be pleased to participate in a consultation process directed to updating the PBSA and creating the possibility of JSDBPs in the federal jurisdiction.

(ii) The PBSA Needs Reform of its Solvency Funding Rules

All workplace pension plans should be ‘funded’ – moneys should be set aside each year to pay for the pensions earned in that year, and, if there are any shortfalls in the pension plan (due, for example, to investment losses) this should be made up through additional contributions.

In Canada, we use two different sets of funding rules.

'Going concern' funding rules recognize that pension plans are long term arrangements, and that, while investment returns and interest rates will fluctuate, there are reasonable, historically based returns and rates that can be used as a basis for funding a pension plan. Going concern funding rules are based on such long term returns and rates, although they are also sensitive to a changing long term environment. For plans that will endure for a long time, and can absorb the volatility of financial markets, going concern funding rules are sensible ways to fund a pension plan.

'Solvency' funding rules are more problematic. They are based on the assumption that the pension plan will be terminated and wound up immediately. In this case, annuities must be purchased from insurance companies for some plan members, and actuarially determined lump sums must be paid to other members. Annuity prices and actuarially calculated lump sum amounts are very expensive.Even though most plans won’t be wound up and forced to buy annuities and make these lump sum payments, the PBSA requires that all pension plans be funded on the assumption that they will terminate and wind-up, and that annuities will be purchased and lump payments will be made. This is a wholly unrealistic assumption for most plans.

The most sensible solution to the problem of termination and wind-up, when we know that some plans will terminate and wind-up but most will not, is not to compel every single pension plan to set aside enough money to cover a wind-up. This is inefficient and costly; most plans won’t wind up and so won’t need to be funded as though they will be wound up. Rather, the pension sector requires a government sponsored pension insurer that will cover those plans that do wind up with a deficiency. The amount of premiums can be determined to cover expected wind-up deficits system-wide, and will cost much less than the current prohibitively expensive PBSA requirement that all plans be funded on the basis that each one of them will be terminated and wound-up.

VI. OTHER PROBLEM FEATURES OF TARGET PLANS UNDER THE FEDERAL DISCUSSION PAPER

A. Earned Pension Promises Will be Broken

Perhaps most outrageous to see from a government with responsibility to protect peoples' pensions, the discussion paper proposes that benefits already earned and paid for by a member in a defined benefit plan - including by retirees - may be cut. Accrued defined benefits may be converted to target benefits, and those target benefits may be reduced. The very benefits towards which members have worked and made contributions, and that have been guaranteed by their employers, may be converted to target benefits guaranteed by nobody.

In the PSAC's view, promises made must be kept. The most basic purpose of pension regulation is to ensure that people can rely on their employers' pension promises, and that those promises are kept. Instead, by its proposed reforms, the federal government proposes that pension promises made by federal sector employers to their employees, may be broken.

The protection of guaranteed vested pension benefits has been the core objective of pension regulation in Canada. Employers have made defined benefit commitments with their eyes open. Employees have worked and contributed to earn those benefits. Federal pension legislation has protected those benefits and prohibited their reduction. The federal pension regulator has been mandated to ensure that vested pension benefits, promised and earned, are delivered. To permit those vested benefits to be undone, even on the basis of some undefined consent process, is unconscionable.

B. The Target Plan Model Does Not Have These Success Factors

Successful pension plans, including JSDBPs, owe their success to a number of factors, including size and scale, access to investments available only to the largest pension plans and a stable contribution base. Critically, however, they also enjoy features that the federal discussion paper ignores. In particular, Canada's most successful pension plans have:

- independent and effective stakeholder control over and responsibility for the pension plan;
- sensible regulatory and governance frameworks;
- vigorous stakeholder support.

‘Target benefit plans’ do not have these features. They

- do not provide for effective stakeholder control over the pension arrangement;
- will be prone to false promises, overly expensive administration and misleading communications;

- will not enjoy vigorous stakeholder support.

C. Under the Discussion Paper's Model, Stakeholders are not Free to Govern their Pension Arrangements Independently

Pension plans are a critical element in the overall wage deal between employers and trade unions. While wages represent employees' current income, pensions represent their deferred income. Together, current and deferred incomes make up the bulk of the overall compensation arrangements between employers and their employees.

As a matter of principle, it is a premise of our society and economy that employers and employees represented by trade unions are free to establish the terms and conditions of employment through free collective bargaining. Collective bargaining establishes the parameters for the overall wage package, and also allocates that package between current and future income.

The way that the overall wage package is allocated, and especially its division between current and future income, is key critical not only to employers seeking to attract and retain employees, but also to members who may be attracted to certain employments specifically because they value the security and stability of a decent retirement income.

The 'target benefit plan' proposal in the discussion paper would impose or require a 'contribution cap' that would limit the amounts that collective bargaining parties could negotiate for the pension plan. Plainly, this interferes with collective bargaining. It unacceptably intrudes on the parties' ability to set the wage package, and to allocate it between current and deferred wages.

Political interference in the establishment of the wage package, or, equally seriously, in its allocation between current and deferred income, fouls up the ability of employers and employees through their trade unions to configure the wage package and its allocation in a way that best suits their mutual interests. Such interference in free collective bargaining constitutes a wholly unjustified violation of the fundamental right to bargain collectively, and jeopardizes the integrity of both the collective bargaining relationship and the pension plan.

JSDBPs in Canada have recognized that pension arrangements are integral to the overall collective bargaining relationship between public employers and pension plan members. They have respected the abilities and rights of public employers and the trade unions representing public employees to set the overall terms of a wage package through collective bargaining, and to allocate the wage package between current and future incomes. This has allowed employee and employer plan sponsors the full range of tools necessary to effectively sponsor their pension plans, and to adapt to changes in circumstances. It has given members confidence in a governance process that has seen contribution levels fluctuate, sometimes at the expense of wage increases, in order to sustain their pension plans. In general, respect for the autonomy of the pension governance process, and the absence of a 'contribution cap' or other legislative interference with the terms of pension governance, has been critical to the sustainability of those pension plans.

D. Under the Discussion Paper's Model, Pension Plans will be Prone to False Promises, Overly Expensive Administration and Misleading Communications

Recent experiments in New Brunswick illustrate the perils of the target benefit regime. New Brunswick has introduced the spin-doctored 'shared risk plan' – a form of target benefit plan. In fact, as the government of New Brunswick admitted to the Province's Auditor General, that there is nothing 'shared' about the risks under the New Brunswick target plan model – the risks (of benefit reductions) are overwhelmingly on the members and retirees in those plans, with employers bearing little or no risk in regard to them.

The New Brunswick experiment is also an experiment with an extraordinarily complex set of rules that are not only virtually impossible to understand, but are horribly expensive to follow. Plans are required to model 20 years into the future, and predict the future to a 97.5% level of certainty – an impossible task that will consume untoward resources and yield up results that will inevitably be wrong.

The New Brunswick example also includes plainly misleading assertions about the security of retirement income benefits. Some of these assertions are based on future modelling, which is passed off as being of virtually scientific accuracy. As New Brunswick's promises fail, confidence in its system will falter and stakeholders will become justifiably angry.

E. Under the Discussion Paper's Model, Pension Plans will not Enjoy Vigourous Stakeholder Support

The discussion paper contemplates a regime in which retirement income benefits may be reduced at any time and by any amount – including for retirees. It is hard to imagine that such a system could enjoy enduring stakeholder support, since it fails the elementary retirement income criteria of security and predictability.

Pensions are in integral elements of labour relations, but they are also a financial product. They provide life income benefits that people depend upon when they can no longer work. But financial products do not entail the level of uncertainty that the proposed 'target benefit plan' would carry.

No one would deposit money in a bank account if their account balance could be reduced at any time and in any amount. No one would agree to pay premiums for a life or other insurance policy if the amount of coverage could be reduced at any time or in any amount. And it would be of little help for the bank or insurance company to say, based on their models, that there is a 90% chance the bank account or insurance policy would retain its value. The models upon which such projections are based are not good enough to provide any real level of comfort at all – after all, much more sophisticated financial models failed in the 2008-09 financial crisis. People want and deserve certainty in their financial products, and nowhere more so than in their pension plans. It is the government's job to regulate financial products, including pensions so that financial promises are kept.

A ‘target pension plan’ does not make a secure and predictable retirement income commitment. A target promise is not the kind of promise that Canadians want or need; it does not sustain pension confidence and it will not maintain vigorous stakeholder support.

VII. SUMMARY AND CONCLUSIONS

- The discussion paper addresses the wrong pension problem, and does so in the wrong ways. The real pension problem is that two thirds of Canadians do not participate in any workplace pension plan, and the real solution to this problem is an expanded CPP. Unfortunately, the federal government has blocked CPP reform for millions of Canadians. The discussion paper treats defined benefit plans that provide decent, secure and predictable pensions as a 'problem' - they are not.

- The key objective of any pension system is to provide decent, secure and predictable pensions. The proposed conversion of defined benefit to target benefit plans will not achieve this objective. To the contrary, target plans will shift financial risk from employers to employees and pensioners, increase pension uncertainty and reduce pension benefits.

- Reforms to the PBSA are required, but reforms are not needed as the discussion paper proposes, to convert good pensions into pensions that provide unreliable benefits.

- Reforms are necessary to allow for jointly sponsored defined benefit plans in the federal jurisdiction. The federal PBSA is a laggard in this respect - well behind Ontario, British Columbia, Alberta and Nova Scotia.

- Reforms are also necessary to relieve pension plans of onerous solvency funding obligations. A public pension insurance arrangement is needed to protect benefit security in those plans that do fail, without burdening the system as a whole with expensive solvency funding requirements.

- The target proposal presents real risks to the Canadian pension system:

    - Employers will convert good defined benefit plans into target plans.

    - Existing benefits earned and paid for by members, and backed by their employer’s promise to pay any deficiency, will be stripped of that employer promise, through some undefined ‘consent’ process. This will mean that employers will be allowed to break the pension promises they have made to their employees and pensioners, who will suffer pension uncertainty and benefit reductions as a result.

    - Under the discussion paper's rules, target benefit plans will be subject to a contribution cap, and so will deny collective bargaining parties the ability to bargain an overall wage package and allocate it fairly between current and future consumption.

- Target plans will be complex and expensive to administer, and will offer benefit security based on models of a future that is 20 years away; no models are capable of predicting the future to a 90% level of certainty, and any promises based on such models are simply misleading and corrosive of Canada's pension system.

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[i] See also LaRochelle-Coté, S., J. Myles, and G. Picot. 2008. Income Security and Stability during Retirement in Canada. Analytical Studies Branch Research Paper Series no. 306. Ottawa: Statistics Canada.