Society of Professional Engineers and Associates

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Introduction

The Society of Professional Engineers and Associates (SPEA) is the union representing the engineering and technical employees of Candu Energy Inc., formerly the CANDU commercial division of the Federal Crown Corporation Atomic Energy of Canada Limited (AECL).

Our members' interest in the target benefit pension model as outlined in the "Federal Consultation Paper - Pension Innovation for Canadians: Target Benefit Plan" arises from the transaction between the Government of Canada and SNC Lavalin that led to the transfer of ownership of the CANDU Commercial division of AECL to private ownership. As part and parcel of that transaction, responsibility for the affected employees was transferred from the Crown to SNC Lavalin.

The agreement provided that those who had been employed by AECL at the effective date of the transaction would continue their participation in the Public Service Pension Plan (PSPP) for a transitional period ending in October 2014. Employees hired after the transaction date would not be eligible for membership in the PSPP.

In negotiations for a first agreement between SPEA and SNC Lavalin, it became clear that the employer was not prepared to step into the shoes of the Government of Canada and provide a pension plan comparable to that provided under the PSPP or, indeed, any defined benefit pension plan. As part of the resolution of a lengthy dispute, the parties agreed on the terms of a letter in which they undertook to pursue the option of a target benefit pension plan as an alternative to a defined contribution arrangement.

As a consequence, we welcome the initiative taken by the Government of Canada to explore the development of a "third option" alternative to conventional employer-sponsored DB plans and DC plans. Our comments in response to the consultation paper are framed by the fact that our members see a target benefit plan as a way to preserve as much as possible of the advantage of a defined benefit pension plan while respecting our employer's reluctance to take on the obligations associated with plan sponsorship. While we are not in a position to comment one way or another on the issues related to conversion from DB or DC to a target benefit pension plan, in our view the critical pre-condition which should apply to all of these potential changes is formal consent, in advance, from plan members and/or their legal representatives.

General comment

In reviewing the document as a whole, we were concerned about the level of detail which the paper contemplates being required in plan documentation and policy documents, particularly as it relates to funding policies, policies for dealing with funding shortfalls and policies for dealing with funding surpluses.

As a general proposition, we believe both the public interest and the interests of potential plan members would be best served by focusing on a robust and accountable governance structure that fairly respects the risk-sharing proposition that underlies the plan design, and by setting out regulations based on principle rather than detailed specification.

Origin and role of target benefit plans

It is important in considering the potential for target benefit or risk-sharing pension plans to be mindful of the context within which interest in such arrangements may arise.

For plan members, such an arrangement would generally be considered a "second-best" or "third-best" solution to the problem of providing for retirement savings. Except in unusual circumstances – a high-turnover industry, for example – employees' preference will normally be for a single-employer sponsored defined benefit pension plan or, failing that, a multi-employer pension plan. The reason is quite straightforward. In a single-employer defined benefit plan, risks associated with short-term fluctuations in investment returns and other key pension cost drivers are borne by the employer.[1] In a multi-employer plan, risks are shared over a larger group of employers and employees than would be the case in a single-employer plan.

Consequently, for plan members or potential plan members, a target benefit or risk sharing pension plan arises as a preferred alternative to Defined Contribution (DC) plans in which all of the risk is borne by the individual.

For employers, a target benefit or risk sharing pension plan has the potential to offer employers the financial benefits (to the employer) of a DC arrangement while at the same time offering a measure of benefit security and risk pooling to plan members.

In other words, the appeal of a target benefit or risk sharing pension plan is that, to the plan member, it looks like a DB plan whereas, to the employer, it looks like a DC plan.

The regulatory regime for target benefit or risk sharing pension plans must be designed with these elements of their appeal in mind. What this means in concrete terms is that, to be effective in creating a real option that will contribute to retirement income security in Canada, the regulatory regime must reflect this duality of motivations.

For plan members, the system must require a clear distinction between the different categories of benefits which are subject to different levels of security and provide for participation and control appropriate to the distribution of risk.

[1] For longer-term risks, the risk-sharing proposition may be quite different. For example, in plans which provide for less than 100% indexing of post-retirement benefits, retirees bear a portion of the inflation risk and, overall, provide a cross-subsidy to active plan members equal to the share of inflation that is not offset by indexing. Similarly, plan sponsors will often respond to continuing experience losses by increasing member contributions or reducing future service benefits, either unilaterally or through labour negotiations.

For employers, it must be recognized that employers will not consider a target benefit or risk-sharing plan as an alternative to a DC plan unless it offers essentially the same financial advantages as a DC plan, namely the ability to control costs (avoiding the risk of unanticipated cost increases) and the ability to avoid incurring liabilities which must be reported on their balance sheets. Our experience with our employer indicates that the desire to avoid pension plan balance sheet liabilities is a prime motivator in its preference for DC arrangements. What this means in concrete terms is that the structure of the pension promise in a target benefit or risk sharing pension plan cannot give rise to employer balance sheet liabilities. It will be important to ensure that the structures and obligations set out in the enabling legislation and regulations avoid creating balance sheet liabilities for accounting purposes.

With respect to specifics, our comments will focus on four of the issues covered by the consultation paper: governance; plan design; provisions for dealing with funding shortfalls (or unfunded liabilities); and provisions for dealing with funding excesses (or surpluses).

Governance

It is critical to note that in a target benefit plan, the employer is not bearing the risks associated with the operation of the plan. The risk sharing inherent in the target benefit model is among plan members, both active and retired. The employer is a stakeholder in a target benefit pension plan. It has and continues to have the employment relationship with the active members of the plan. And it has a continuing interest in the performance of the plan because that performance will determine the value to its employees of an important employee benefit. However, the employer is not a participant in the plan to the same extent as the employees. Its costs will generally not vary with plan performance. Even in cases where a plan provides for employer contribution increases under certain circumstances that risk is limited, and does not extend to the risk associated with the absence of a benefit guarantee. The employer is not part of the risk-pooling framework.

In general the employer should be represented in governance as a stakeholder. It should not dominate or control the governance structure and should normally be represented in the governance structure with a single representative with or without voting power. The consultation paper appears to contemplate continuing employer control of the process, with required representation of employees and pensioners as stakeholders. It is our submission that this balance should be reversed.

We view it as important to distinguish between control of and responsibility for the appointment of the trustees of the plan and the responsibilities and composition of the board of trustees itself. It is both legitimate and appropriate for the legislation to require that relevant skills and expertise be represented in the governance of a plan. But boards of trustees should not be self-replicating. There must be an appointing body that is accountable to the participants and stakeholders. The model used in Ontario, where there is a sponsoring body that is independent of and responsible for appointing the board of the plan, is one that works well and should be considered as the default model.

Finally, it is vital that target benefit plans be initiated by consensus or agreement on the part of participants.

Plan design and funding

The consultation paper contemplates a highly prescriptive structure under which different classes of benefits would be established with different degrees of security. This distinction is appropriate. It would permit plan designers to communicate to plan members that their benefits incorporate a component that is closely related to a traditional defined benefit and a component that is variable or contingent. This kind of distinction might also encourage plan designs that provide for inflation protection as a major component of the more variable component. This would be an appropriate outcome, given that the principal source of short-term variability in plan finances is investment returns.

The paper goes on to mandate one of two specific approaches to the management of the risks associated with the absence of an external guarantor.

We believe that this approach is far too prescriptive. The legislation should set out clear principles that must be respected in plan design, including the establishment of and funding approaches to the different levels of guarantee associated with different categories of benefits. We would support the requirement for a clearly defined funding policy subject to regulatory review, but we believe that it is unnecessarily restrictive to limit the funding approaches to the two standards set out in the consultation paper.

Response to potential funding shortfalls or surpluses

The consultation paper contemplates requiring that plans set out a clear hierarchy of response options in the event of an adverse funding event or funding shortfall or a favourable funding event or surplus. We believe that this is unnecessarily prescriptive and limiting. It is not possible to predict in advance all of the possible circumstances – both internal to and external to the plan – that might influence the optimal choices in this regard.

We believe that as it relates to adverse or favourable funding events, the legislation should set out principles that should be followed in response to these events and require that plans identify in advance an inclusive list of potentially available options in response to these events, but it should neither specify in detail what plans can and cannot do, nor require that plans adopt a detailed roadmap of required responses to funding events in advance.

Striking a balance

It is critical that enabling legislation and regulations be sensitive to two key facts: workplace-based pension plans are, at root, employment benefits; and workplace-based pensions are not mandatory. The first of these facts implies that the creation of new target benefit pension plans and the conversion of other plan forms to target benefit should proceed in a way that is consistent with the legislative framework governing the particular employment relationship. Where the employment relationship is governed by a collective agreement, the legislation should require agreement or consent through the collective bargaining relationship. Where the employment relationship is not governed by a collective agreement, the legislation should require specifically that changes be subject to the common law and employment standards rights of the employees.

The second of these facts requires that the legislation and regulations balance the need to protect plan members against the need to ensure that the model continues to be an attractive alternative to DC and DB plans favoured by employers and employees respectively. We are concerned that the structure contemplated by the consultation paper is sufficiently prescriptive that it runs the risk of rendering the target model dead on arrival.

In the end, we believe that strong, accountable and responsive governance, coupled with clearly defined principles set out in legislation, is the best way to ensure that the right balance is struck in each plan under its particular circumstances.

Conclusion

We welcome both the potential introduction of target benefit or risk sharing pension plans as an option for employees and employers in Federal labour jurisdiction and the opportunity to comment on the structure before it becomes law.

SPEA and its members identified a target benefit plan as a viable alternative to the employer's insistence on a DC plan in negotiations for our first agreement following the sale of the business to Candu Energy. We were able to secure the employer's agreement to pursue a target benefit option in the resolution of a lengthy labour dispute. We are hopeful that this new model will be available in time, and will be structured in such a way that our members can benefit from it.

We look forward to the outcome.