

Securing Retirement for the Next Generation of Pilots

Submitted by

The Air Canada Pilots Association

June 23, 2014

*Submitted in response to the consultation process by the Department of Finance
Canada*

Pension Innovation for Canadians: The Target Benefit Plan Consultation Paper

Introduction

This paper is being submitted in response to a call for consultation on the proposed new federal Target Benefit Plan (TBP) pension arrangement. The Air Canada Pilots Association (ACPA) has a vested interest in this process, as our newest members (post 2012) have been placed in a Defined Contribution (DC) pension plan. ACPA is hopeful that this proposed initiative will eventually allow employers in the federally regulated landscape to offer more security in retirement to employees currently in a DC plan.

At the outset, we will offer the following answers to the two broad questions asked in the introduction of the consultation paper:

Question 1) Should TBPs be an option available to employers and employees of federally regulated DB or DC plans?

Yes. These plans provide greater security for employees in retirement than a DC plan. They also strike a good balance for employers who are not willing to underwrite the solvency volatility associated with a DB plan, and who require a fixed schedule of contributions.

Question 2) Would you consider converting your federally-regulated DB or DC plan to a TBP plan if this option was available? Why or why not?

If this initiative results in the establishment of TBPs in the federally regulated landscape, ACPA would like the option of pursuing the conversion of our current DC plan for new hires into a TBP. Under the current DC plan, employees shoulder an unreasonable amount of investment risk on an individual basis, risk that could be greatly reduced using the pooled investment and mortality features of the TBP.

Administration and Governance

Question 1) Is this governance framework appropriate for federally-regulated private sector and Crown corporation pension plans wishing to convert to a target benefit plan?

ACPA has no fundamental objections to the proposed governance framework.

Question 2) 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)?

Yes, the federal legislation should specify representation by all parties (actives, retirees, and plan sponsor) and expert representation agreed to by both employee and employer.

Question 3) *Should the Board of Trustees have powers to amend plan documents?*

In the same manner as our current DB and DC plans, the proposed Board of Trustees could amend the plan either to reflect a change in legislation, or change that is agreed upon by both the employee and employer. These changes should require the final approval of OSFI.

Question 4) *What should be the plan member support level requirement for making substantial amendments to the plan text?*

Any plan text amendments would be made by mutual agreement of employee and employer, unless voted down by an absolute majority of members (50% + 1).

Funding Policy

Question 1) *Is the going concern valuation sufficient to measure and fund target benefits?*

Yes, a going concern valuation should be sufficient. Although not required to fund explicitly for solvency, a TBP should be tested for solvency. The solvency ratio would be applied to the initial payment for a member leaving the plan with a commuted value.

Question 2) *Which approach should be adopted under the federal legislative and regulatory framework: the margin or the probability test?*

The margin approach. It is simpler, easier to explain to members, and the actuarial methods to apply it are already in place.

Question 3) *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)?*

Both should be allowed, and communicated to members in the most simplified way.

Question 4) *What is the appropriate time horizon for the purposes of calculating the PfAD?*

Three to five years is an appropriate time horizon. This strikes the right balance of smoothing out temporary statistical spikes in investment performance and mortality experience, yet allows the plan sufficient time to recover from the downturn of a typical airline business cycle.

Question 5) *Should going concern valuations be required on a closed group or open group basis?*

Generally speaking, the open group approach is preferable to the closed group approach, because it takes into account expected changes in the demographic composition of the membership during the financial projection period. If the funding policy requires a financial projection over a long time horizon (such as 10 or 15 years), then an open group approach would be more robust than a closed group approach. When using an open group approach, it is necessary to consider a broader range of assumptions than those traditionally made for actuarial valuations - for example, projected growth or decline in the airline industry and Air Canada's market share, future hiring and retirement patterns and policies, age profiles for future newly trained pilots, etc.

Traditionally, the closed group approach used by ACPA's actuaries has been considered a satisfactory way to measure the cost of pensions for a stable population of active plan members over relatively short periods between valuation dates (maximum of 3 years). A 'stable' population means a constant demographic profile, in which an older member who retires is assumed to be replaced by a younger new hire so that the average age of the full active population remains steady. It is also possible to use a closed group approach over longer time horizons if there is no reason to expect a meaningful demographic shift within the plan population over that time period.

For a new TBP open only to new hires, an open group approach would need to be used because the plan would start out with relatively young members, and the demographics would change significantly as the plan matures.

Question 6) *How frequently should valuations be required?*

Valuations should be performed annually, however corrective measures need not be taken immediately. This is discussed in the Funding Deficit Recovery Plan.

Question 7) *Should some of the specifics on the funding policy (e.g., PfAD rates) rely on guidance from sources such as the Canadian Institute of Actuaries (CIA) or should they be more fully prescribed in legislation or regulations?*

The CIA should be the authority. They react faster to changes in macroeconomic factors.

Contributions

Question 1) Is this approach to contributions for federally-regulated plan appropriate?

Yes, we believe the proposed approach to contributions is appropriate. However, we would insist on exploring the possibility of both employer and employee variable contributions.

Question 2) Should some of the specifics concerning contributions be determined by plan members or more fully prescribed in legislation or regulations?

These specifics should be determined by plan members. Every plan is different and the contribution schedule must be tailored to each plan. Such specifics could include varying the contribution split between employee and employer

Benefit Structure

Question 1) Is the approach of categorizing a benefit in two classes appropriate?

Yes, this approach is appropriate.

Question 2) Should base and ancillary benefits be determined by pension plans or more fully prescribed in federal legislation or regulations?

The legislation should provide a range of options, but the distinction between these two types of benefits should be prescribed solely by plan members and the employer when drawing up the TBP.

Funding Deficit Recovery Plan

Question 1) Should the deficit recovery measures and their prioritization be determined by plan members or more fully prescribed in federal legislation or regulations?

These measures should be laid out by plan members, not federal legislation. Every plan will have different priorities for sharing the risk of under-funding between actives and retirees.

Question 2) Should deficit recovery measures be triggered as soon as the PfAD starts to be depleted or the probability test is not met?

The plan members should determine the timeline. However a maximum period of the subsequent valuation report plus 6 months (nominally 18 months) would be an appropriate time frame. This would be a reasonable compromise between absorbing any statistical aberrations, yet still acting in a timely fashion to address any funding deficiencies.

Funding Surplus Utilization Plan

Question 1) Should the surplus utilization measures and their prioritization be determined by plan members or more fully prescribed in legislation or regulations?

These measures should be established by employer and employees during the setup of the plan. The federal legislation should offer a range of options available to the authors of the plan text.

Question 2) What would be an appropriate margin (over the fully-funded level) to allow surplus utilization? What would be an appropriate cap on the utilization of surplus?

A funding margin of 5% over the PfAD would be an appropriate margin before allowing spending of the surplus. As an example, assume a PfAD of 8%. Contributions would be set to target a funding level of 108%. The surplus would be allowed to grow to 113% before the surplus utilization measures are phased in.

125% of the going concern funding target would be an appropriate cap, mirroring the DB cap on funding holidays. This would allow very conservative plans in a volatile industry to maintain a robust buffer, yet still provide the federal government with assurances that employee contributions are not being needlessly sheltered from tax.

Disclosure and Communications

ACPA has no comments on the disclosure and communications proposed in the consultation paper. Our current DB plan issues annual statements to each member with a summary of earned benefits as well as an update on the health of the plan. The plan sponsor also issues periodic updates whenever there is a material change in either the financial situation of the plan or a proposed change in benefits. This communication process would provide sufficient information to members of a TBP.

Conversion of Pension Plans to Target Benefit Plans

Question 1) What views, if any, do you have on converting federally-regulated DC plans to TBPs?

ACPA opines that the DC plan currently in place could potentially be converted wholesale into a TBP. At this point, there are less than 200 members in the plan (out of a total pilot population of 3000) and total assets in the DC plan are less than \$1 million. It is a fairly straightforward actuarial exercise to cost out the dollar value of 1 year or 1 month of service in the TBP. Members in the DC plan would be provided with the cost to buy back this service, and then given the option of 'rolling over' their current DC accounts to purchase all or a portion of their service in the new TBP. All future service would be accumulated in the TBP. We support having this option available to plan members.

Portability and Locking-in Rules

Question 1) 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 PBSA contains strict guidelines with respect to portability and locking-in rules for DB plans. In the case of a TBP, the legislation should mirror these rules, particularly for a member who terminates from the plan during a period of benefit reduction or funding target deficit. An appropriate mechanism would be a solvency holdback on transfers out of the plan.

Individual Termination

The methodology for an individual termination would be similar to that described above in Portability and Locking-in Rules. However, upon termination a member should also be entitled to collect his/her portion of any going-concern surplus in the plan in accordance with the employer/employee agreement regarding surplus.

Plan Termination and Wind-up

Question 1) What are your views on the formula used for calculating termination value? Would it be more appropriate to use the solvency-funding ratio?

ACPA agrees that upon termination and wind-up, all plan members and retirees of federally-regulated TBPs should be entitled to the commuted value of their benefits as they exist at the time of wind-up. However, the consultation paper contemplates using a going-concern funded ratio during a wind-up. This is problematic in our view, as a going-concern valuation compares the relationship between the value of plan assets and the present value of expected future benefit cash flows in respect of

accrued service, assuming the plan will be maintained indefinitely. This is clearly not the case in the event of a wind-up, and a solvency valuation would appear to be more appropriate in this case. The CIA, in consultation with OSFI, would be the final authority on the appropriate methodology to be applied.

In the event of windup the plan should be provided the option of securing the benefits with annuities purchased on the open market or continuing to operate as an independent trust fund. Using the solvency calculation is simply not realistic when the liabilities cannot be matched with annuities. If the plan sponsor no longer exists then the plan should have the option of continuing to 'exist' on a going concern basis under the same or a modified investment strategy and continue to payout pensions from the fund. Using the solvency valuation for a condition of wind-up is exactly the problem we have today with DB plans. Such a requirement will only drive funding models to require solvency funding levels at all times. Going concern funding levels should be suitable as stated above.