Submission by the Canadian Union of Postal Workers

to the

Department of Finance consultation on a potential federal framework for target benefit pension plans

June 2014

Introduction

On April 24, 2014, the Department of Finance Canada released "Pension Innovation for Canadians: The Target Benefit Plan, Consultation Paper". The Canadian Union of Postal Workers ("CUPW") represents about 50,000 people, most of whom work in federally regulated industries.

The purpose of this submission is to provide Finance Canada with CUPW's opinions about the establishment of target benefit plans at the federal level in Canada. CUPW is strongly of the view that there is a need for a public debate about the funding rules for pension plans. A discussion that focuses on target benefit plans will not allow for a meaningful discussion because target benefit plans are not in the interests of pension plan members or beneficiaries. Target benefit plans put the pension benefits of working people at risk of loss.

There needs to be a balanced, open and fair discussion about the utility of solvency funding. In particular, there needs to be a discussion about whether pension plans sponsored by crown corporations should be required to be funded on a solvency basis. As the sole shareholder of Canada Post, the Federal Government stands behind any pension obligations that are owed to members of the Canada Post Corporation Registered Pension Plan (the CPC). Unlike a private sector employer, the Federal Government does not face any risk of becoming insolvent. Given that the Federal Government will be in place to act as a guarantor of any unfunded liability, the CPC Plan should not be required to be funded on a solvency basis.

If the pension plans of crown corporations are not required to be funded on a solvency basis, such plans should be required to be funded on a going concern basis. We note that this is the approach that has been used in Ontario for jointly-governed pension plans

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CUPW believes that jointly-sponsored pension plans are the best form of pension plan governance. CUPW is concerned that the concept of joint governance could become tainted because it is being discussed in the context of target benefit plans. In our view, the interests of pension plan members would be served if joint governance was put forward in a more neutral context.

Viewing employers as being solely responsible for the unfunded liabilities of a pension plan ignores reality. Employers employ a number of strategies to ensure that the risk is shared by employees. For example, employees receive lower wages or benefits in exchange for maintaining their defined benefit pension plans.

In other cases, employers shift the entire risk to employees through converting defined benefit plans to defined contribution pension plans. In these cases, employees lose income security and are forced to make investment decisions without adequate support or necessary advice.

For these reasons, then, describing target benefit plans as "shared risk" plans is misleading because it suggests that employers alone bear the risk of an underfunded pension plan. Members of defined benefit plans already "share" the risk of defined benefit plans. Wages, working conditions and other benefits are often sacrificed in order to maintain pension benefits. In addition, pension plan members can find themselves as involuntary creditors of their employer if the defined benefit pension plan is underfunded and their employer becomes insolvent.

Unlike other creditors, members and beneficiaries of a pension plan do not get to choose if they will lend money to the plan sponsor. Instead, plan members too often find themselves in a circumstance where plan sponsors have made poor or unnecessarily aggressive decisions that have directly led to the underfunded position of the pension plan. Plan beneficiaries bear these risks even though they have no involvement in the decisions that sponsors make about the pension plan.

As we have noted, members and plan beneficiaries already share the risk in a defined benefit pension plan. In the case of the CPC Plan, the plan sponsor has unilaterally decided that members will be responsible for fifty percent of the current service cost of the plan. Despite the fact that CUPW members are now responsible for fifty percent of current service costs CUPW members have no say in the decisions made by the plan sponsor about the CPC Plan.

CUPW believes that any solution to pension funding problems that results in the reduction of accrued pension benefits should not be permitted. Retired members met the employment obligations they owed to their employers. In exchange, they received the pension they earned through their labour. Plan sponsors should not be permitted to escape their pension obligations. Similarly, active members who have earned their benefits should not lose them for the convenience of plan sponsors.

If target benefit plans are approved as a design option any benefits that have accrued before the conversion date should not be subject to reduction. Rewriting a deal on or after the fact basis is not only unfair, it may not be legally permissible. The Federal Government may not have the constitutional authority to take away any vested property rights of retirees and pension plan members. In light of these considerations, reduction of accrued pension benefits should not be allowed.

CUPW is also concerned that the consultation process around target benefit plans will take away from the real debate that needs to occur about pension plans. The key feature of a target benefit plan is it is not required to be funded on a solvency basis. The pension experience of the last decade suggests that solvency funding does not work for employers or plan members. A public debate about the efficacy of solvency funding would be both a more direct and useful approach to this issue.

CUPW says this in part because target benefit plans are emotionally charged. Linking an end to solvency funding with a reduction in member benefit places the entire burden on pension plan beneficiaries. A discussion that instead focussed on the efficacy of solvency funding might lead to a more productive interest based discussion instead of the inevitable position based, acrimonious discussion that is likely to occur.

CUPW also believes that any discussion about the funding of pension plans should also focus on the way in which pension plans are invested. Pension plans should be invested in a manner that takes account of pension plan liabilities. There is no requirement for plan sponsors to take account of plan liabilities when investing plan assets. If liabilities were taken into account, plan volatility could be significantly reduced and plans would be far more sustainable.

Similarly, a discussion about joint governance should also be made in a less charged environment. Joint governance should not come at a cost of reduced benefits. Members already bear significant risk and responsibility, but typically have no authority. The experience of jointly governed plans in Ontario supports the view that members will manage the plans in a prudent manner that best protects the long-term interests of plan members and beneficiaries.

For ease of reference, the CUPW response to the questions raised in the consultation paper will be answered in the order the questions were posed.

Interest in Target Benefit Plans Among Employers and Employees

CUPW notes with concern that only plan sponsors – typically the employer – of federally regulated registered pension plans were asked for their opinion about whether target benefit plans should be an option for federally regulated pension plans. With respect, plan members and beneficiaries should also be asked for their opinion. If target benefit plans are made available, then the pension benefits of plan members and beneficiaries will be put at risk.

As noted in the introduction, pension plan members already share the risk of defined benefit pension plans. This risk is "shared" through reduced wages and benefits, less generous pension benefits or, in the case of an insolvency, reduction in accrued benefits. Moreover, this risk is often borne without any involvement by plan members in the governance of the plan.

Seeking the opinion of plan sponsors alone reinforces a view that sponsors alone carry the risk. In the interests of fairness and balance, plan members should also be asked for their opinions.

CUPW believes the issue of whether target benefit plans should be an available design option is the wrong starting point for this discussion. The real issue is whether the existing solvency funding regime works in the current, government mandated, low interest rate environment.

Solvency funding assumes a plan will wind up on the valuation date. The policy rationale for this approach, presumably, is that solvency funding will protect plan members in the event the plan sponsor ceases operations.

There is very little evidence, if any, to support the view that solvency funding, of and by itself, protects the interests of pension plan members and beneficiaries. During periods of economic downturn the funded position of pension plans worsens. This typically occurs because the value of equity holdings decrease while the value of a plan's liabilities increase as interest rates fall.

Solvency funding does not protect plan members against falling equity markets and declining long-term interest rates. Instead of solvency funding, plan sponsors, plan members and plan beneficiaries would all be better served by a pension funding regime that seeks to limit any mismatch between pension plan assets and liabilities.

Another weakness of solvency funding is that plan sponsors and plan members are required to take action in the form of increased contributions in the midst of, or in the immediate aftermath, of an economic downturn. Requiring extra funding when the parties to the pension promise are in their weakest economic condition does not seem prudent.

The result of these factors is that solvency funding does not achieve its stated purpose. Economic realities create a circumstance in which plans are not fully funded when they are most likely to terminate. As a result of these considerations, CUPW recommends that Federal Finance consult with stakeholders about more sensible funding rules instead of consulting about target benefit plans.

While the case for solvency evaluation is not a strong one in the private sector, it is non-existent in the public sector. Governments do not go out of business. Accordingly, it is not sensible to fund public sector pension plans on a solvency basis. In Ontario, for example, large jointly-sponsored public sector pension plans are exempt from solvency funding.

CUPW is also of the view that crown corporations and other government entities should not be subject of solvency funding obligations. Canada Post is an "agent" crown corporation. As CUPW is often reminded, the Government of Canada is Canada Post's only shareholder. Given the creditworthiness of the Government of Canada, a solvency funding obligation is unnecessary for Canada Post.

4.1 Administration and Governance

CUPW believes that jointly-governed pension plans are better than governance models in which the employer controls all of the decisions. The Federal Government recently imposed a requirement for employees of Canada Post to contribute fifty percent of the current service costs to the CPC Plan. Even though members are now required to pay one-half of the current serviced costs, members have no role in the CPC Plan's decision making process.

CUPW believes that all pension plans that require active members to contribute fifty percent of current service costs should be jointly governed.

The federal government should not prescribe the composition of the body governing the plan. The parties to the pension promise should be given the authority to determine the composition of the governing body.

The governing body should not have the authority to amend plan documents. The amending power should be within the sole purview of the collective bargaining agents and the employer. Any changes to the plan would, as a result, need to be agreed upon and ratified as part of the collective bargaining process.

Non-unionized workers will not have an equal bargaining relationship with the plan sponsor. In addition, non-union employees will not have access to the expertise they require because they will not have the resources to retain the expertise they require. Non-unionized employees may also run the risk of facing retaliation if they do not go along with their employers' wishes.

From a practical point of view, target benefit plans may not be workable in the non-union environment. The inequality in bargaining plus the potential for employer reprisal will not be resolvable in the absence of a union to protect member interests.

4.2 Funding Policy

4.2.1

CUPW acknowledges that the funding policy of a defined benefit pension plan is certainly the structural element that contributes most to the stability and predictability of contributions required for adequate funding and to the protection of the plan benefits.

The need for a new funding framework

The disastrous financial results of these pension plans over recent years have highlighted the weaknesses in the current funding environment. CUPW believes that all stakeholders need to quickly take advantage of lessons learned and implement a new and essential funding framework for the survival of these plans.

It must be recognized that both the going concern and solvency actuarial valuations did not adequately respond to the expectations of stakeholders:

- On the one hand, the underlying methodology for a going concern valuation certainly brings the desired stability over years with respect to the level of required current service contributions. However, the absence of adequate margins exposes both employers and participants themselves to financial consequences resulting from the obligation to inject unplanned and substantial additional special payments to compensate the inevitable (and sometimes significant) fluctuations in expected returns on assets of these plans;
- On the other hand, although the rules governing solvency valuations. (rules that can be described as static) are relevant in the case of termination and wind-up of a defined benefit pension plan, its systematic and prescribed use in the situation of a pension plan that continues its existence does not create stability of funding. In fact, these rules clearly threaten the existence of the defined benefit pension plans considering the exorbitant costs they impose on sponsors particularly in a difficult economic context and thereby miserably fail to protect the benefits for the active and retired participants. The unsuccessful measures of relief implemented over the last years clearly illustrate this statement.

That is why a single funding framework taking into account the continuity of a pension plan and the expected return in line with the investment policy that also includes an explicit margin in the current service cost appears to be the most promising of available avenues. This margin would represent the difference between the actual contributions made to the plan and the current service cost.

Risk of termination

The risk of termination and wind-up of a pension plan should also be taken into account, modulating the required level of the margin according to the organizational permanence of the employer and, therefore, the permanence of the plan. Thus, the more an organization is found to be permanent, the lower the required margin. For example, Crown corporations like Canada Post would thus be assigned a high level of permanence and, therefore, the required margin would be lower. However, the plans of organizations in the private sector would be subject to a higher margin, reflecting the generally higher risks associated with termination of operations and wind-up cost of these plans and offering better benefit protection to the participants, especially in the event of a bankruptcy.

The introduction of a funded margin

The implementation of this margin necessarily passes through one or the other or a combination of the following avenues:

- raising contributions, but without improving the rights and benefits, or
- reducing the rights and benefits, but keeping unchanged the level of contributions.

CUPW wishes to emphasize that, although the consultation document is silent in this regard, the effort made by the participants to establish this margin will be considerable. They are those who would have to increase their contributions and/or reduce their rights and benefits and it would not be the employer. It is still the employer at the end of race who directly benefits from this effort since the objective of this new funding framework is to significantly reduce the probability of a deficit with respect to future participation and thus the probability of having to make special payments, which are currently the employer's responsibility. Moreover, in many cases, an employer will also see its current service contributions reduced in the negotiation process leading to the creation of the margin, allowing it to redirect the savings made in this regard to the amortization of a past service deficit. Finally, any change in the current service rights and benefits will result, if not in the short term at least in the medium term, in a change in behavior of retirement among participants. This will reduce the value of the past service liabilities of the plan and, consequently, any deficit related to these liabilities. This concept of margin is currently in force in the municipal and university sectors in the province of Quebec.

4.2.2 Questions

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

For the reasons mentioned above, CUPW calls to retain a single type of valuation, namely the going concern valuation, and thus permanently abandon any recourse to solvency valuation.

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

CUPW believes the legislation should require mandatory funding of an explicit margin in excess of the current service cost to the accumulation of a cushion for adverse deviations for all defined benefit pension plans. A transition period would be necessary for this purpose. Moreover, legislation should expressly provide that this provision could in no case be used to finance any deficit whatsoever in relation to participation credited before establishment of the margin.

CUPW also believes the legislation should impose a minimum margin level. The level established by the legislation should be sufficiently high that it effectively ensures high stability of contributions. This would avoid a plan adopting an insufficient level of margin, which would weaken the plan. It should certainly not be appropriate that the legislature sends the signal that the exercise to implement more effective risk management can be done by halves.

CUPW also sees the provision for adverse deviations fueled by this margin as a reserve tank for future special payments. More details on this will be given in the next section on contributions.

CUPW considers that the level of the margin should always be expressed as a percentage of the current service cost, which would automatically adjust the margin according to fluctuations in the current service cost.

After examination of the impact of parameters such as maturity and distribution of plan assets on the level of the margin as illustrated in a research paper published by the Canadian Institute of Actuaries (CIA) in January 2013 (Provisions for Adverse Deviations for Going Concern Actuarial Valuations of Defined Benefit Pension Plans), CUPW believes it would be useless to take into consideration such parameters due to their small impact on the percentage that could be retained by the legislator.

As already mentioned, this margin should be adjusted according to a factor of organizational permanence, that is to say, as it applies or not to pension plans sponsored by perennial organizations, in order to take into consideration the risk of termination and wind-up generally associated with them. For example, drawing on the study of the CIA, CUPW would be comfortable with a margin which would be set at 20% of current service cost for plans sponsored by perennial organizations. Obviously, this level of margin should be allowed to be achieved over several years given the effort required to achieve it.

Such a margin would also play a significant role in a plan termination. In such an event, the solvency ratio, even if the solvency is not funded, would consequently be higher, ranging around 90% or more. For plans sponsored by non-perennial organizations, the level of margin should be higher, around 30%, which would provide a solvency ratio of closer to 100%.

As for the probabilistic approach, CUPW believes it is too complex and hermetic for participants and should be rejected.

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)?

For CUPW, the adoption of an approach to establish an explicit provision for adverse deviations that is adequate invalidates maintaining an additional margin included in the discount rate. For the sake of transparency, any stabilization margin should be explicit. Such a margin implicitly included in the current service cost should then be transformed into an explicit provision. This would facilitate the creation and funding of the margin and the provision for adverse deviations, supporting the huge effort made by the participants in this regard.

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

Financing a provision for adverse deviations and the use of a going concern approach would considerably reduce the need for a dynamic projected funding of the plan's assets and its cash contributions and benefits and a comparison of the assets and liabilities of a pension plan at the end of any horizon. In this context, CUPW doubts that any additional information that could be provided by the introduction of a time horizon can be significantly useful in view of the complexity involved and the cost implications.

However, if in the plan actuary's opinion, taking into account subsequent events might come to change its assessment of the financial position of a plan (e.g. a special evolution of the demographics of the group or a significant change in the investment policy), the actuary at anytime issue an opinion in this regard in the actuarial valuation report.

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

The reasoning supporting the answer to the previous question also applies to this question. CUPW doubts that the use of an open group basis can be significantly useful except perhaps in a very particular context.

How frequently should valuations be required?

Given the presence of a provision for adverse deviations, CUPW does not see the need or even the utility to produce a statutory actuarial valuation more frequently than every three years. Obviously, a board of trustees should regularly closely monitor the evolution of the financial position of the plan and have the flexibility to prepare an actuarial valuation more frequently if deemed appropriate.

Should some of the specifics on the funding policy (eg, 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?

CUPW believes that the legislature should prescribe in detail but still in a simplified way the main elements of the funding policy, based on relevant studies and recommendations such as those provided by the actuaries and the CIA.

4.3 Contributions

4.3.1

There are two components to the funding of a pension plan, the investment return on the assets of the pension fund and the contributions paid by employers and participants.

Although the investment policy is designed to achieve long-term returns based on the expectations and goals of a board of trustees in accordance with guidelines established for this purpose, it cannot effectively ensure the stability of returns over future years or control their level. We must therefore turn to the second component, contributions, to play this essential role.

Pre-financing of the amortization payments

The weakness of the current funding framework is that although contributions are determined and paid in advance and in an orderly manner to finance the current service cost as established annually by the plan actuary, those required to meet future deficits and potential experience deficits and thus stabilize the funding effort — and at the same time, protect the benefits — are not subject to any such planning. At closer look, it is amazing that we have so long considered such an approach as normal yet incompatible with the nature of the funding of a defined benefit pension plan, which presupposes adequate and regular pre-financing of the retirement benefits over an active participation period.

CUPW acknowledges the need to address this weakness if we want to ensure the sustainability and viability of defined benefit pension plans. However, the approach inherent in the concept of a target benefit pension plan goes too far since in allowing a reduction of rights and benefits already accrued, it aims to make the weight resting directly on the shoulders of participants and completely absolves employers of any social responsibility for the security of retirement income for their employees.

A contribution policy

CUPW believes the legislation should require and oversee the establishment of a contribution policy allowing for better management of the risk of fluctuation in the performance component. This would be an extremely powerful tool that would significantly reduce the risk to an employer of having to endure an unsustainable level of special payments without fully disengaging it from its responsibilities. Such a contribution policy, if properly articulated, would obviate the use of target benefit pension plans requiring the reduction of rights and benefits already accrued. By rigorously defining the substance of a contribution policy, legislation would deliver the message of the absolute need for the adequate funding of the promises of a pension plan. Instead, promoting the establishment of target benefit pension plans would lead to withdrawals of employers and transmit the message that even if funding is not adequate, it is always possible to reduce plan benefits.

In CUPW's opinion, an articulated contribution policy should define in detail five types of contributions, their source and their use:

1. ***The current service contribution***

   It is the contribution made according to the design of the pension plan agreed by the negotiating parties and determined by the going concern actuarial valuation. The design of the pension plan as well as the sharing formula of the current service contribution between the employer and participants should belong to the field of free negotiation and agreement between the parties.

2. ***The stabilization contribution***
   As mentioned in the previous section, it is the contribution necessary to build an explicit provision for adverse deviations.

   The level and the sharing formula of the stabilization contribution between the employer and participants must be subject to negotiations between the parties.

3. ***The special payment drawn on the provision for adverse deviations***

   Should a deficit occur during the existence of the pension plan, special payments would be required to amortize the deficit. Rather than having to inject new money, an employer could draw on the provision for adverse deviations for such special payments as required.
   This use of the provision for adverse deviations is consistent with its nature. Since this provision is fueled by contributions paid in advance, CUPW believes that it should not be considered as a surplus which would absorb some or all of a deficit but as a reserve tank for special payments at the disposal of the employer. The use of the provision would allow both an orderly funding of a deficit while providing better protection for the employer against the possibility of having to make special payments.

4. ***The stabilization contribution used as a special payment***

   In the event the special payment is insufficient, the stabilization contribution, in part or in full, would be temporarily transformed into a special payment. The unused part of the stabilization contribution would however continue to be put into the provision for adverse deviations.

5. ***The additional special payment***

   Finally, in the event that the above measures are insufficient and it is necessary to inject any additional amortization contribution, the employer would have to fully assume such contribution. The payment of this additional special payment would cease when no longer required.

It is important to understand how such a contribution policy offers substantial protection to an employer without the need to have recourse to a final step of reduction in rights and benefits. It is a responsible and supporting way that would meet the respective needs of the parties and allow an harmonious implementation of effective risk management.

4.3.2 Questions

Is the proposed approach to contributions for federally-regulated plan appropriate?

The contribution policy developed above would provide better protection for the employer than that proposed in the consultation document, taking into account the different use that is made of the provision for adverse deviations and of a stabilization contribution. Such an approach has received a positive welcome by the plan participants where it is applied in the municipal and university sectors in the province of Quebec. It is the result of a dialogue between the different stakeholders, including the employer, the unions and the government. It was implemented without the parties seeing any need to impose a cap on employer contributions.

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

Given the importance of a contribution policy to the sustainability and viability of a defined benefit pension plan, CUPW believes the methodology for determining the different types of contributions, their source and their use as well as a minimum level of the provision for adverse deviations should be clearly prescribed. The signal wouldn't then contain any ambiguity: employers and plan participants share responsibility for the sustainability and viability of defined benefit pension plans and should act promptly and in concert to adequately fund these plans in all their aspects.

Any decision regarding the sharing formula of contributions between employers and participants, however, must be subject to negotiations and agreement between the parties.

4.4 Benefit Structure

4.4.1

The target benefit pension plans: not a privileged solution

CUPW strongly reiterates its position that the implementation of legislation defining the parameters for target benefit pension plans and authorizing a reduction of accrued rights and benefits of participants is not a privileged solution to address structural deficiencies in the funding of the defined benefit pension plans.

Such legislation would create doubt as to the obligation of a party to meet its contractual commitments, a value deeply rooted in our Canadian society. It would undermine the value of the defined benefit pension plans recognized by all stakeholders as the best tool to ensure financial security in retirement. In addition, it will give an ambiguous signal to the need for adequate funding of these plans and serve as a caution to employers to evade their responsibilities to provide financial security for their retired employees. The result would be a dangerous weakening of the Canadian pension system.

CUPW believes the Ministry of Finance Canada is wrong in seeking ways to stabilize the costs of these plans by shifting the burden of funding stability solely to the participants. More moderate, effective and socially acceptable solutions are known and available. As explained above, legislation requiring the mandatory establishment of an articulated contribution policy would meet the goals and expectations of each party without resorting to reductions in accrued rights and benefits on the backs of participants.

An exceptional measure

Despite its strong opposition to the principle of target benefit pension plans, CUPW however cautions that, even if such legislation is definitely incompatible with permanent organizations such as Crown corporations, which are able to meet their pension commitments especially in a context of restructured funding, it could be useful in certain circumstances in the private sector. But it should remain an exceptional measure applicable only in extreme circumstances.

For example, in Quebec and Ontario, in the pulp and paper sector, such an exceptional situation arose. Employers on the verge of extinction — workers on the imminent verge of losing their jobs — sought court protection under the Companies' Creditors Arrangements Act (CCAA). The parties recognized the need to restructure the pension plan in order to avoid a disastrous bankruptcy for all. Negotiations led to the establishment of a target benefit pension plan allowing these employers to stabilize their current service contributions. These employers, however, have had to finance a substantial margin, and in exchange, the participants agreed to allow an extreme measure of readjustment of their benefits to cope with any future deficit that may arise. Provisions defined in relation to past participation benefits, however, were met and maintained.

CUPW believes that, in such exceptional cases, any legislation that would allow the establishment of a target benefit pension plan should have a limited scope:

- It should only be available to employers from the private sector whose organizational permanence is very low;
- It should be exhibited beyond any doubt that maintaining a defined benefit pension plan is a real threat for the survival of the business;

- A joint request from the employer and the union or association representing the employees must be addressed to OSFI for this purpose;
- A reduction in the accrued rights and benefits could be allowed only if the contribution policy makes provision for a substantial margin, as explained above;
- Defined benefit provisions in relation to past participation must be maintained.

In addition, a target benefit pension plan may also be an intermediate step towards a defined benefit pension plan for groups of employees who currently participate only in a defined contribution plan or in a group RRSP or simply do not benefit from any pension plan.

4.4.2 Questions

Is the approach of categorizing benefit in two classes appropriate?

Even in the context of a restricted legislation scope as described above, CUPW does not believe it is appropriate to define benefits classes in order to give them different degrees of protection.

On the one hand, it will definitely be difficult for participants to understand the basis and scope of such a categorization. Indeed, such categorization would send the message that some benefits are less important than others in the design of a pension plan. This is certainly not the case. Each has its purpose and its importance but not necessarily the same importance for all participants. For example the provision for early retirement or death benefit after retirement will carry different priorities by different participants.

On the other hand, it could lead to choices where a reduction would affect only some of the participants, i.e. where the deficit would not be supported by all or the vast majority of participants. This would be the case if the bridging benefits were cut, as retirees aged 65 or over are no longer receiving them.

In the opinion of CUPW, where necessary, and taking account the establishment of an articulated contribution policy with a robust margin and provision for adverse deviations, it would be simpler, more acceptable, and fairer to be able to reduce only the level of the lifetime pension. All participants, both active and retired, would then be affected in their rights and benefits. In addition, effort made by the participants would then be better proportioned to the value of the benefits related to each of them since the lifetime pension constitutes the major portion of it.

Such a possibility of reduction is not a panacea, especially in light of intergenerational equity. Indeed, even if both the active and retired members have rights and benefits in the pension plan, there is a fundamental aspect that differentiates them. For active participants, it is future rights and benefits while for retired members, it is current income. Thus, reduction in the lifetime pension would not have the same financial impact for all. For retired members, it would be a tangible, immediate and a unrecoverable loss. However, for active participants, the loss might only be potential as there might be recovery of these rights and benefits before they retire.

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

In the opinion of CUPW and as mentioned in the answer to the previous question, such categorization is not necessary.

4.5 Funding deficit recovery plan

4.5.1

A recovery plan in line with the contribution policy

For CUPW, the recovery plan should be detailed and be part of the pension plan text. It should be implemented as soon as an actuarial valuation reveals a deficit. As explained in **Section 4.3 Contributions** this plan would include the following three steps:

1. The use of the provision for adverse deviations as a reserve tank for special payments when a deficit is reported. Thus, an employer could draw directly from the provision for adverse deviations any special payment required for each of the years covered by the actuarial valuation.

2. The transformation, in part or in whole, of the stabilization contribution to a special payment in the event that the provision for adverse deviations is insufficient for this purpose.

3. The payment by the employer of an additional special payment in the event that the stabilization contribution is insufficient.

CUPW has already explained above why we did not agree with a funding approach that would result in any reduction to accrued rights and benefits.

A shared responsibility

CUPW emphasizes the fact that the responsibility of a deficit is shared. Indeed, even if the employer uses the provision for adverse deviations or the stabilization contribution as special payments, these first two steps are the result of substantial efforts made by active participants, that either by increasing contributions or reducing their rights and benefits for current service. Such restructuring of funding having generally led to a reduction of employer contributions for current service. This is why the employer is solely responsible for the third step, the least risky of the three.

The implementation

CUPW shares the position of the consultation document to the effect that the authority and the obligation to implement the recovery plan would be given to the Board of Trustees, without then needing the consent of the active and retired participants. Such consent having been implicitly obtained at the time of implementation of the contribution policy.

4.5.2 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?

As already mentioned in a similar question related to the contribution policy, CUPW believes the recovery plan should be prescribed in the legislation. The steps and their order of priority are indicated above.

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

CUPW believes the recovery plan should engage as soon as an actuarial valuation reveals a deficit with respect to the financial position of the accrued benefits, regardless of the level of the provision for adverse deviations. This approach is consistent with the nature of this provision that constitutes a reserve tank for special payments available to the employer.

4.6 Funding surplus utilization plan

4.6.1

Careful use of surplus

The objective of the establishment of a provision for adverse deviations is to ensure a better stability of contributions and pension benefits protection. CUPW believes that great caution should be exercised when used for purposes other than those for which the provision was established.

However, a rational use of the provision for adverse deviations should include measures if its level becomes (and remains after use) superior to the set level and provided that the plan is not at the time of such use in a deficit position. In this regard, the legislation should be limited to authorize the use of funding surplus as long as prudent criteria are met.

In general, CUPW favors that the surplus in respect of future participation remains in the provision for adverse deviations to enhance the sustainability and viability of the plan. This would be as much to the benefit of participants and employers. However, the parties could agree on the use of the surplus if the provision reaches a particularly high level. For example, in the event that additional special payments are paid by the employer, the parties could agree that such payments be recovered, concurrently or not to benefit improvements.

One use of surplus to prioritize: conditional indexation

We have previously explained that the funding of a sufficient margin to significantly reduce the likelihood of having to make special payments would require a huge effort by participants. In many cases, participants may have forfeited, in whole or in part, a provision of automatic indexation of pension benefits to assist in creating the necessary space for a margin. In a context of significant margin, CUPW believes it is important to prioritize the replacement of the automatic indexation by annual and ad hoc adjustments of conditional indexation paid directly through the provision for adverse deviations. The granting of such adjustments would be conditional to the financial health of the plan, which means they would be paid if the level of the provision exceeds a certain threshold, e.g. 50% of the set level.

Such use would not be reckless and could be allowed since the value of these adjustments would be very small compared to the provision for adverse deviations created by a significant margin and would only slightly decrease the level of provision with this utilization. The benefits for which an adjustment would be applicable would be only for years of participation where the retirees have contributed to the margin. Furthermore, the methodology for determining such adjustments would be fair, not only aiming at gradually distributing their fair portion to the participants already retired but also at retaining the portion of the provision necessary for that purpose for future retirees. Finally, the adjustment levels would be only established for the period covered by an actuarial valuation. Once determined, the additional benefits resulting from these adjustments would however be payable for the lifetime of the retired participants.

Such use of the provision for adverse deviations for purposes of conditional indexation has been subject to a regulation under the Supplemental Pension Plans Act in Quebec for municipal and university sectors.

4.6.2 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 prescribed and what should their order of priority be?

CUPW believes that legislation should be restricted to state in which situation a plan would be allowed to use its funding surplus and to allow the parties to determine the nature and level of priority of improvements that could be funded by surpluses. However, such use should be part of the pension plan text.

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?

CUPW recommends the establishment of an articulated contribution policy that includes a robust minimum margin of 20% of the current service cost for permanent organizations and 30% for other organizations. Given this characteristic, CUPW believes that a surplus could be used as soon as such level is reached and as long as a plan is not in a deficit position.

As explained above, a plan where significant margin is funded could allow a conditional indexation when the level of the provision exceeds 50% of the level set for the provision.

4.7 Disclosure and Communications

Canada Post meets the minimum statutory standard for communication to plan members and beneficiaries. Accordingly, CUPW believes that any enhancement to the communication process would be valuable.

4.8 Conversion of Pension Plans to Target Benefit Plans

CUPW strongly believes that accrued benefits should not be subject to reduction. Retirees, as well as active members, have earned these benefits. Reducing these benefits amounts to a retroactive amendment to their collective agreement.

4.8.1

CUPW strongly disagrees with the conversion of a defined benefit plan for a target benefit plan. As we have mentioned so far, even for future service, our organization promotes the safeguarding of defined benefit plans where benefits will be guaranteed. It goes without saying we cannot accept an approach that will reduce benefits that have already been guaranteed for years of past service.

Suppose it is theoretically possible for active participants to modify their financial planning for retirement because they know several years in advance the impact of the reduction of their accrued benefits. It is clear that for retirees who receive a pension, this change in financial planning is impossible since the impact of the reduction would occur immediately. However, if choosing to allow conversion only in the case of active participants, the government will face a problem: it would be a blatant intergenerational inequity that will lead workers to an exodus to retirement. But Canada needs workers with expected aging of the workforce. In summary, any kind of reduction in accrued benefits for past service will surely result in a failure.

We remind that the rights of the defined benefit plans were granted in good faith often following great concessions at the bargaining table. It is grossly unfair to reduce these rights without compensating workers for the sacrifices that were made at the time.

A reduction of accrued benefits for past service could lead to a social crisis without precedent.

In our opinion, the first step is to take care of future service with the financing of a significant margin for adverse deviations. Future service and past service would be in two separate components. The two components would be within the same plan, but are separated by a bulkhead. The financing and provisions are therefore separated in two parts. Changes are impossible for past service with the exception that for crown corporations, funding of solvency would no longer be necessary which will help to create a lot more stability in contributions for past service.

4.8.2 Questions

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

According to CUPW, all accrued benefits must remain unchanged and guaranteed. Conversion to a target benefit plan is unacceptable.

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

Not applicable

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

As stated above, at the end of 4.4.1, a TBP could be an intermediate step towards a defined benefit pension plan for employees currently in a DC plan.

4.9 Portability and Locking-in Rules

4.9.1

CUPW agrees with PBSA portability rules.

4.9.2 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?

Not applicable

4.10 Individual Termination

4.10.1

Two choices must be provided at termination: a deferred pension according to the plan's conditions or the transfer value of the deferred pension. Since the pension is guaranteed under CUPW's approach, the pension value must be calculated according to the Canadian Institute of Actuaries standards for transfer values. We know that the calculation method prescribed by this standard is not perfect and has often been debated. However, we believe it is reasonable to continue to apply it in order to determine what constitutes a fair value, knowing well that the standard may change over time.

We do not believe it is necessary to provide a part of the provision for adverse deviations to participants who choose the transfer value. The objective of the provision is to ensure the sustainability of the plan in a perspective of continuity. Although participants who terminate employment have contributed to its funding, the reserve should not be used for any other purpose than for which it was established, the funding stability and benefits indexation in a perspective of continuity. It is not intended to improve the entitlement upon termination of employment (or in a broader sense at plan termination). In contrast, those who retain their benefits in the plan will be entitled to a portion of the reserve as it will continue to protect them against fluctuations in experience over years and it can be distributed to them in the form of indexation.

4.10.2 Question

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

Our previous comments answer this question.

4.11 Plan Termination and Wind-up

As explained previously, in case of termination and wind-up, participants who have not reached the retirement eligibility age would be entitled to a transfer value of the deferred pension according to the conditions provided by the plan. This value is calculated according to the standards of the Canadian Institute of Actuaries.

The rights of retired participants may be paid by an annuity purchase from an insurer. Participants who are still active, but are eligible for retirement, would have the choice between the transfer value and an insured annuity. We know the insurance market for indexed annuities is too small to meet demand in the event of wind-up of a large pension plan like Canada Post pension plan. However, assuming the indexation would often be conditional for future service, it would no longer be part of the guaranteed benefits in the event of plan termination and it would no longer be taken into consideration for annuity purchase. Thus, this problem would be gradually eliminated over time.

Any reserve available at the termination and wind-up would be available to the employer because the participants concern is to get the value of their guaranteed rights, neither more nor less. In case of deficit, the reserve allows the employer to reduce the additional required funding at termination. In other words, even if the solvency is no longer directly funded during the life of the plan, the available reserve allows the employer to avoid running a substantial risk upon termination. In case of surplus, this reserve is refunded to the employer.

On a final note, CUPW must agree with the Superintendent's declaration of termination.

4.11.2 Questions

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

The transfer value should be calculated according to the standards of the Canadian Institute of Actuaries, essentially according to a solvency method. Participants should not receive less than the amount calculated according to this standard, but in contrast, no portion of the reserve for adverse deviations should be granted to them.

In other words, there would be no adjustment ratio to the value: in case of solvency deficit, the employer should cover the deficit and in case of surplus the employer would be entitled to the excess.

What are your views on applying solvency requirements in the case of plan termination within 5 years of conversion from a federally-regulated DB plan?

For CUPW, the conversion is unacceptable and no time frame prior to the effective termination could make it legitimate.

The most fundamental protection is to ensure that accrued benefits cannot be reduced upon conversion. A reversion to a solvency funding regime is an illusory protection. Over the five-year period, the funded position of the converted plan is likely to worsen. An employer winding up the plan may well be insolvent. The amount of the unfunded liability would likely be an unsecured claim against the estate of the insolvent company.

In light of those considerations, the best way to protect member interests is to prohibit the reduction of benefits accrued prior to the date of the plan conversion.

/rgcope225

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