CANADIAN FEDERATION OF PENSIONERS
ADVOCATING FOR PENSIONERS

FÉDÉRATION CANADIENNE DES RETRAITÉS
POUR LES RETRAITÉS

23 June 2014

Sent by e-mail to: pensioners@fin.gc.ca

Subject: Submission of the Canadian Federation of Pensioners to the Finance Canada consultation on Target Benefit Pension Plans

Attached is the submission of the CFP regarding "Pension Innovation for Canadians: The Target Benefit Plan, Consultation Paper (April 2014)". This submission may be posted on the website of the Department of Finance. You may use quotes from this submission and attribute them to the Canadian Federation of Pensioners. The CFP does not make a claim of confidentiality for any portion of this submission.

(*Original signed by*)

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Attachment

Submission of the

Canadian Federation of Pensioners

regarding

"Pension Innovation for Canadians: The Target Benefit Plan"

Consultation Paper (April 2014)

issued by

Finance Canada

23 June 2014

Contents

Executive Summary

The target benefit pension plan (TBP) framework is both a source of hope, and a source of great concern for Canadian pensioners.

If done properly, it can be a helpful option for employers, and a source of security for their employees and retirees. If done poorly, it can undermine the security that members of existing defined benefit pension plans (DBP) had thought they had already ensured. Whether their defined benefit plan is federally-regulated or provincially-regulated, plan members understand that a poorly crafted TBP framework will ultimately harm them.

Whether the TBP framework is properly crafted or poorly crafted turns on the issue of consent. If conversion of a DBP into a TBP is done in a way that forces a DBP member to accept the very different pension promise of a TBP, then the pension security that he or she has worked a lifetime to earn would be very much at risk. It would allow employers to rewrite their side of the work bargain. It would retroactively change the rules of the workplace, and would be no different than permitting an employer to claw-back income an employee had earned in earlier years. It could sound the death-knell of the pension security that DBP plans afford millions of Canadians today. While pensioners should be able to rely on government rules to reinforce the commitments made to them, a poorly crafted TBP framework would cause pensioners to rely instead on the good will of their DBP plan sponsor, or the courts, to protect the pension promises made to them.

CFP is encouraged that the consultation paper contemplates plan conversion only upon consent. However, the paper does not define the means by which consent would be ascertained. The fundamental core of this submission is that the legislative framework must hold employers and plan members to the commitments that they have made, and that these commitments can be replaced by a TBP only if positive and informed consent is given by the individual to do so.

In this submission, CFP explains that any involuntary conversion of the DBP commitment made to an individual into a TBP:

- would break the pension promise made to DBP members, and, in so doing, harm them significantly;
- could result in additional burdens being placed on the existing social safety net as more seniors, deprived of their DBP commitment, have to turn to the government to pay for necessities;

- would undermine intergenerational equity;
- is premised on the myth that defined benefit plans are unsustainable;
- would open employers to protracted and contentious legal battles with their own employees and pensioners; and
- would be seen by Canadians as government allowing employers to break the commitments that they have made to their plan employees and pensioners.

An Ipsos Reid survey conducted in June of 2014 bears this out[1]. This study found that while a substantial proportion of Canadians (44%) recognize the difficulty employers may have in providing pensions for their employees and pensioners, many more — more than nine in 10 Canadians (94%) – agree that employers should live up to the commitments they have made to pensioners and employees.

And Canadians are clear that they expect their Government to make sure this happens: 92% agree that in developing a new pension framework, the federal government should ensure that companies honour the commitments made to pensioners and employees.

These Canadians would wonder how it is that the government decries the fact that too many Canadians are ill-prepared for their retirement years, and at the same time encourages forced reductions to the retirement incomes of those who had legitimately thought their defined benefit pension plan had prepared them reasonably well for their future.

If a poorly crafted TBP framework permits employers to abandon the commitments they have already made to the members of their DBP plans, then Canada may well see the end of defined benefit pension plans. This would happen not because honouring the DBP commitment would be an unsustainable proposition, but because government rules would have put in place financial incentives that were too enticing for employers to resist. As the DB pension promises are broken, and in particular when the increased risks are realized by pensioners in the form of lower pension payments, then pensioners will know that government has broken faith with them.

CFP proposes many measures regarding the development and administration of an effective TBP. These measures share the following objectives:

- commitments must be honoured;

[1] (http://ipsos-na.com/news-polls/pressrelease.aspx?id=6545)

- informed consent of all individuals in an existing pension plan is paramount;
- plan texts should include all elements that could affect achievement of the target;
- there should be a bias in favour of negotiated agreements among parties authorized to represent the interests of groups of plan members;
- plan administrators should bear a fiduciary duty to plan members;
- with one possible exception, all pension benefits should be afforded the same level of protection; and
- in some instances, legislation and regulations should specify minimum standards to be included in the plan text, with negotiations determining whether measures in excess of the minimum standards are warranted.

Introduction

The Canadian Federation of Pensioners (CFP) is pleased to comment on the proposals and considerations in Finance Canada's consultation paper regarding target benefit pension (TBP) plans. CFP represents the pension interests of defined benefit plan members across Canada. Whether provincially-regulated or federally-regulated, the twenty private sector member organizations of CFP[2], who together represent 250,000 plan members, recognize the extent to which these proposals will ultimately impact the pension landscape across the country. A properly crafted TBP framework can be a helpful option for employers, and a source of security for their employees and retirees. If poorly crafted, it can undermine the security that members of existing defined benefit pension plans (DBP) had believed they had already ensured.

As the next section describes, if the TBP framework allows employers to abandon the commitments they have already made to members of their DBP plans, Canadians will be harmed.

1.1 TBP: increasing the risk borne by plan members

Throughout this submission, "plan member" refers to any individual who receives, or will ultimately receive when certain conditions are met, pension benefits from a pension plan. Accordingly, active employees, retirees, deferred pensioners, and those in receipt of spousal benefits are all plan members.

Relative to a defined benefit pension plan, a target benefit pension plan increases the risk that the pensioner's pension income will be reduced.

In a DBP, the benefits to be paid by the plan are established in advance. Should the plan's assets be judged to be insufficient to pay for these benefits, then the employer must make payments into the plan to make up the difference. In this sense, it is the employer that bears the risk of insufficient funding. An important exception is in the case of sponsor insolvency and subsequent plan wind-up, a not uncommon experience in the private sector. If at that time the underfunded plan is unable to meet the wind-up

[2] Appendix 1 lists the member organizations of CFP

obligations of the plan, and the plan members are unsuccessful in an insolvency proceeding to bring the plan to full-funding levels, as is typically the case, pensions are inevitably cut. In this instance, it is the pension plan members who bear the risk of plan underfunding.[3] Another exception is in the case of jointly-sponsored defined benefit plans where employers and employees share responsibility for plan funding.

By contrast, in a TBP the benefits to be paid by the plan are not established as a commitment. Rather, they are set as a "target". Poor plan performance may make achievement of that target unattainable. In that instance, measures are taken so that the target benefits are commensurate with the assets of the plan. Measures can include some or all of:

- increasing the employer's contributions to the plan
- increasing the employees' contributions to the plan
- reducing the benefits of the plan

Consequently, the risk of insufficient funding is borne in part by the employer, should the first measure be taken, and in part by plan members, should the second and third measures be taken. The insolvency risk, discussed in the preceding paragraph, continues to be borne by the plan members. In fact, in the TBP contemplated in the consultation paper, this risk is considerably greater than the corresponding risk associated with a DBP. This fact is discussed in section 2. 1.

It is the transfer of risk to plan members from the employer that has given rise to the use of the term "shared-risk" when discussing TBP. As is noted above, the facts are that a DBP is not riskless to a plan member, and it would not be wrong to call a DBP a shared-risk model. However, it is also a fact that a TBP places even greater risk onto the plan member, and removes it, to a large extent, from the employer.

1.2 In the absence of established pension promises, TBP is a useful tool

Consider the situation where no workplace pension plan exists. The employees in that workplace have not been promised a pension, of any form, in exchange for their labour. A TBP would constitute a novel

[3] The issue of the protection provided to pension plan members when their plan sponsor is insolvent is a matter being canvassed in the ongoing consultation regarding the review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act. CFP is actively engaged in that consultation process as well.

promise, and would help these employees prepare for their retirement years. Of course, the pension promise in this case would entail the risk that the target might not be met. As long as that is made clear up front to employees, then they can take that risk into account when considering what other measures they might undertake to prepare for their later years. The risk of employer insolvency and its consequent impact on their TBP should also be explained up front, and tracked over the lifetime of the plan. Employees can incorporate the risk of insolvency into their financial planning as well.

In a workplace that offers a defined contribution pension plan (DCP), no commitment to the level of benefits has been made. Rather, the contributions have been defined up front, and it is understood, or should be understood, by the employees that the pension benefits would be commensurate with the value of the plan, which in turn is based on contributions and plan performance. In this case, employees may find that a TBP would be preferable, or they may decide otherwise. The salient point, however, is that conversion of a DCP into a TBP would not break pension promises that have already been made.

In both these situations, TBP may be seen as useful to both the employer and the plan members. Subject to the discussion below regarding TBP plan design and governance, CFP accepts that TBP is a valuable option.

In the case of a workplace that offers a DBP, pension promises have already been made. If conversion to a TBP would undermine those promises, then it is unacceptable. The next section describes how conversion of a DBP into a TBP would undermine the DBP pension promise, and concludes that conversion is unacceptable unless the DBP plan members retain the option to remain in their defined benefit plan.

2. Honouring Pension Promises: an important, but missing, objective:

The consultation paper posits two objectives for the TBP, namely "pension sustainability" and "benefit security." The latter objective is characterized as "the pension plan delivers on its pension promise." CFP agrees fundamentally with the objective that a pension promise should be delivered. Indeed, this entire submission could be summarized entirely in terms of that objective:

Pension promises must be honoured.

However, the objective given in the consultation paper speaks only to the pension promise embodied in the TBP. It does not speak to the pension promises that have already been made to current members of a DBP. In fact, the TBP framework proposed in the consultation paper is incapable of achieving the existing pension promises. Therefore, should the TBP framework be forced upon any DBP plan member involuntarily, it would fail its most important test. It would fail the objective of honouring the pension promises already made. In the following sections, it is demonstrated that the imposition of a TBP against the will of a DB plan member:

- breaks the pension promise made to DBP members, and, in so doing, harms them significantly (section 2.1);
- undermines intergenerational equity (section 2.2);
- opens employers to protracted and contentious legal battles with their own employees and pensioners (section 2.3);
- is premised on a myth that defined benefit plans are unsustainable (section 2.4); and
- will be seen as government breaking the pension promise by allowing employers to abandon the commitments they have made, and burdening the social safety net (section 2.5).

As long as the TBP framework embodies the objective of honouring commitments already made, then the harms noted above will be avoided, and TBP will serve as a valuable option for employers and their employees. The manner by which that objective can be incorporated into the TBP framework is presented in section 2.6.

2.1 DBP conversion to TBP breaks established pension promises, and harms pensioners.

The DBP promise is that a certain benefit, subject to indexation as applicable, will be paid throughout an individual's retirement years. The quid-pro-quo is that the employee will have already provided his or her service commensurate with that benefit.[4] In the case of retirees, their work life has been lived, and their accrued benefit corresponds to their entire service with that employer. In the case of active employees, at any given time they will have accrued some pension benefits in respect of their service

[4] In the case of some DBP, the employees' part of the bargain also includes the obligation to make contributions to the pension plan.

years to that point. The pension that they have been promised for their service is a deferred wage, to be realized upon retirement.

To be clear, the promised DBP is not "like a wage," nor "in the nature of a wage." It is a wage. It is one element of total compensation, contracted with the employer, and the expectation of it being honoured should be no less than the expectation that the promised monthly paycheck be delivered to employees. The only difference between one's monthly salary/wage and one's pension is the timing of payment. Reducing a pension amount that has been promised is the same as retroactively demanding that paychecks issued in 2012 be returned in 2014, effectively reducing the 2012 wage retroactively.

The TBP contemplates that the benefits that will be received in respect of service provided under the DBP promise can be reduced. For retirees receiving a DBP payment, upon conversion to a TBP, their previous pension payments are at greater risk. If the plan performs poorly, then one of the measures permitted would be for employers to reduce their pension payments. For active employees who accrued DBP benefits prior to conversion, their ultimate pensions would also be affected negatively under the same circumstances.

Plan sponsor insolvency under a TBP will impose an even greater risk to pensioners than it does under a DBP. The reductions a pensioner will suffer from a TBP plan windup will be greater than had a DBP been wound-up in insolvency. The reason is the funding rules proposed for TBP.

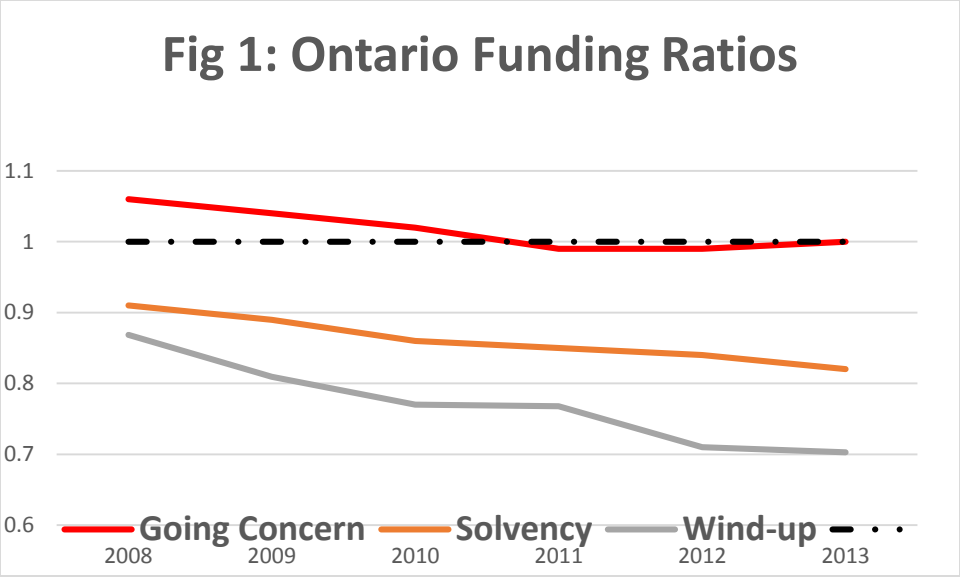
For DBP, employers are required to fund their plans to satisfy two funding criteria; namely, both the going-concern valuation of the plan, and the solvency valuation of the plan must show that plan obligations can be satisfied. The first criterion demonstrates that the plan can meet the obligations to its members should the employer remain in business. The second demonstrates that the plan can meet its obligations should it be wound-up. In effect, the funding requirements are intended to secure the pension promise made to plan members, whether or not the employer continues. Should there be a funding shortfall, by either standard, the employer is required to bring the plan to full funding over time. Any going-concern shortfall is to be eliminated over 15 years. Any solvency shortfall is to be cleared over time as well, with each succeeding year eliminating 20% of the remaining shortfall.

For TBP, the solvency valuation will not be used for funding purposes, with one exception discussed below.[5] Rather, it is proposed – under one option offered - that only the going-concern valuation be used, together with a factor for adverse deviation (PfAD). That factor would have the effect of raising the funding target above the going-concern standard to some extent, depending on the size of the factor. In assessing the risk that pensioners bear when the sponsor is insolvent, one has to consider whether a plan considered fully-funded by the going-concern standard would be capable of meeting its obligations should the plan have to be wound-up. There is hard data that answers that question, and the answer is that pensioners can expect some significant losses, even for plans that they had been told were fully funded.

The Office of the Superintendent of Financial Institutions (OSFI) regulates and supervises financial institutions and private pension plans subject to federal oversight. OSFI does not make available data that permits a comparison of the going-concern and solvency funding ratios of federally-regulated plans. However, a wealth of information concerning the funded status of several hundreds of DBP that are regulated in Ontario is available. Among other statistics, the Financial Services Commission of Ontario (FSCO) tracks the funded ratios of Ontario-regulated plans. Figure 1 below depicts the average going-concern, solvency, and wind-up ratios for the last several years. [6]

[5] It is proposed that solvency valuations will be used for funding purposes should a TBP be wound-up within five years of a conversion of a DBP. This is discussed in section 3.9

[6] Source: Sixth through Tenth Annual Reports on the Funding of Defined Benefit Pension Plans in Ontario, Financial Services Commission of Ontario.



In the FSCO reports, the solvency calculations do not take into account some of the plans' provisions, such as, indexation. However, all plan provisions are included in the wind-up ratio values. Hence, it is the wind-up ratio that measures the proportion of the plan's obligations that can be met should the plan be wound-up. For federally-regulated plans, all plan provisions are included in the calculation of the solvency liability. Accordingly, the wind-up ratio in the FSCO reports is the counterpart to the solvency ratio that pertains to federally-regulated plans. The chart shows that, on average, should a DBP be wound-up it would be incapable of meeting 30% of its obligations. At the same time, the data also illustrate that, on average, the plans are fully-funded on a going-concern basis. The conclusion is that a plan can appear to be fully-funded by the standard of funding proposed in the consultation paper, yet fall well short of what is required to deliver the target benefit should it be wound-up.

Should a plan be less than fully funded on a going-concern basis, the impacts of insolvency on pensioners would be worse still. Depending on the terms of the TBP's funding policy, the funding shortfall could persist for a very long time. The longer the shortfall persists, the greater the chance that a sponsor insolvency would occur at the same time as the plan is underfunded.

The promise already made to members of DBP will not be honoured upon conversion to TBP.

The preceding argument is not a plea for a change to the funding rules of TBP. The only way to preserve the DB pension promises already made would be to duplicate the DBP funding rules in a TBP model, effectively making little or no change to the balance of risks now inherent in defined benefit plans. This would defeat the purpose of introducing the TBP option.

The DBP pension promise would be broken through the combined effect of two decisions; the first decision is the choice of the funding model for TBP, the second decision is to allow an involuntary conversion of a DBP to a TBP. CFP has acknowledged that a funding model different from DBP can be useful. The TBP model has an objective that is clearly and significantly different from the objective of a DBP model. The TBP model is designed to deliver the target benefit, which is subject to change, as long as the employer remains in business. The DBP objective is to deliver the promised benefits, which are not subject to change, whether or not the employer remains in business. Conversion of DBP to TBP shifts the pension objective accordingly.

It is the imposition of the TBP objective onto the employees and retirees who contracted for the very different DBP objective that gives rise to the abandonment of the pension promise.

2.2 Intergenerational equity is undermined by the proposals

"Intergenerational equity" is cited as a guiding principle. It is characterized as a situation where there would be no undue transfers to one generation at the expense of another. CFP agrees that this is a worthy goal, and supports its inclusion in the TBP design. Unfortunately, the proposals presented in the consultation paper are incapable of delivering on that principle.

If benefits that have already accrued are reduced, then plan members (active and retired) who provided their work years for the promised DBP benefits will, in effect, be giving up benefits so that employees and the employer would make smaller contributions to the plan than would otherwise be required. As an example, a retiree may be forced to give up indexation provisions. The subsidization that the TBP design allegedly avoids is still present, and flows from those who have already put in the years of work, to those who have yet to provide their service.

As another example, assume the situation where the plan is performing well, and can support an increase in benefits. In this instance, the retiree would see an increase in his or her pension payment, greater than the one contracted under terms of the DBP. To the extent that one can attribute the plan performance to the efforts and contributions of current employees, the subsidy flows from employees to retirees. At the heart of this intergenerational inequity is the decision to impose TBP objectives onto those who had worked, and planned their lives, according to the DBP objectives.

Intergenerational equity can be restored, should the TBP framework permit retention of benefits already accrued under DBP principles.

This is discussed further in section 2.6.

2.3 DBP conversion opens employers to legal battles

Throughout their working lives, and reinforced upon retirement, plan members have been provided a description of the pension benefits that they would be receiving through their post-retirement years. This represents the commitment made by the employer to the former employee, the embodiment of the pension promise. Pensioners have lived their part of the bargain. It cannot be assumed that the commitment can be ignored simply because another pension option is made available. DBP members, including retirees, will hold employers to the commitments that have been made to them.

2.4 There is no need to harm members of defined benefit pension plans

The consultation paper is premised on a myth: DBP are unsustainable, and therefore their promises must necessarily be broken. The facts do not support this proposition.

DBP have existed for decades in Canada. The eighties and nineties were characterized more by plan surpluses and contribution holidays than anything else. Certainly the market events of 2008 were a shock to financial markets generally, and to pension plans – of any sort – in particular. The sudden plan shortfalls that appeared in 2008 persist to this day, though to a lesser extent. But it is important to understand the reasons, and they are not reasons that would cast doubt on the systemic sustainability of defined benefit plans.

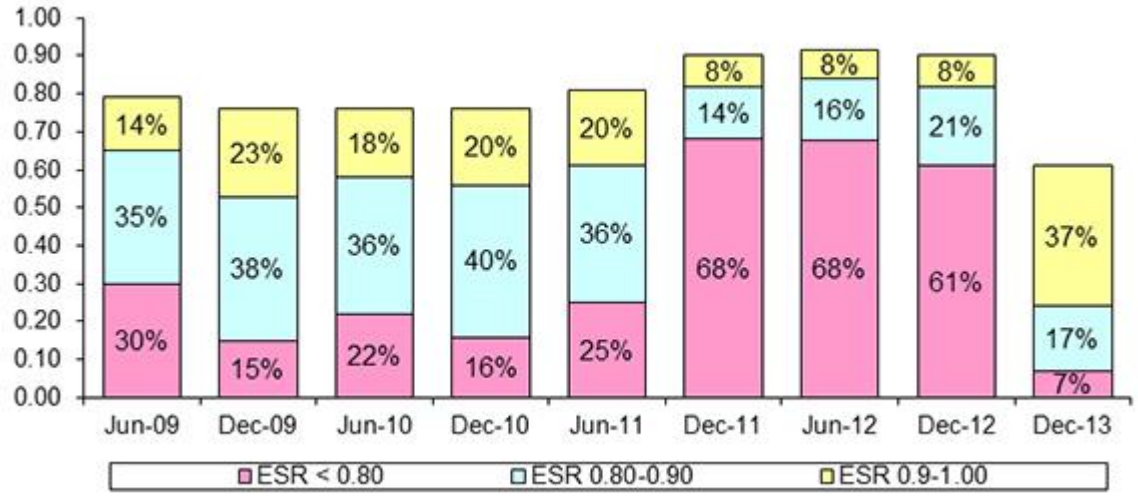
On the asset side, the market has rebounded. The asset losses of 2008 have recovered. It is fair to say that the events of 2008 demonstrated that there was too high a reliance on equity markets in pension plan investment strategies. Responsible plan sponsors have taken steps to reduce this investment exposure. A shift from equity into fixed income vehicles is one means by which sponsors have "de-risked" their plans.

The prevalence of plan underfunding today is driven in large part by persistently low interest rates, which have the effect of increasing plan liabilities. Interest rates have been driven by government and central bank fiat internationally, and even small changes towards historic levels can have a dramatic affect.

Figure 2 demonstrates the combined effects of changing market performance and interest rates over time. It depicts the solvency status of federally-regulated plans, in terms of the estimated solvency ratio (ESR) pertaining to the last several years.[7] The ESR measures the proportion of a plan's solvency liability that is covered by the plan's assets. For example, at year-end 2012, 90% of plans were underfunded, and 61% had a funding shortfall of at least 20%. One year later, a substantial improvement in funded status is observable. The percentage of plans that were underfunded fell from 90% to 61%; the percentage of plans that had a shortfall of at least 20% fell from 61% to 7%. The average estimated solvency ratio for 2013 was 98%, up from 83% the year before.

[7] Source: Office of the Superintendent of Financial Institutions, InfoPensions, Issue 11, May 2014

Figure 2: Percent of Plans with Estimated Solvency Ratio less than 1.0



A recent Russell Investments Canada study reports that for the largest 25 corporate DBP sponsors in the country, their DB plans have shown marked improvements in the last year.[8]

	2013	2012
Median funding	97%	86%
Unfunded pension liability as percentage of market value	0.4%	4.5%
Unfunded pension liability as percentage of cash flow	3.5%	19.7%

DBP funding rules have contributed to the funding problems of the last decade. Federally-regulated plans were permitted to go three years between plan valuations and resetting funding requirements, delaying corrective action. Funding targets were set to just meet plan obligations, without any allowance for adverse deviation. The events of 2008 were extreme examples of adverse deviation, and very few plans had built up surpluses that would have allowed them to weather the storm. The income tax act, too, worked against establishing a funding buffer for hard times, limiting allowed surpluses to only 10%. There was no mechanism available to an individual sponsor that would permit it to tailor its

[8] As reported by J.McFarland in the Globe & Mail, 11 June 2014.

funding obligations to the unique circumstances of its own situation. For federally-regulated plans, these funding rule flaws have been corrected in recent years, at least in part.

That employers might wish to divest themselves of their DBP obligations does not mean that defined benefit plans are unsustainable, it simply means that some employers have found them costly, and less necessary in the labour market than was previously the case. There are already measures available to address these concerns.

First, employers are permitted to close their plans to new members at any time. In effect, the employer/employee bargain is changed for these new employees, creating a new bargain that does not entail the DBP promise. Closing the plan to new members leaves the pension promise for existing plan members intact.

Second, employers are permitted to wind-up their plans at any time, upon condition that the plans are fully-funded within a specified timeframe. This legislative provision allows sponsors to curtail their DBP obligations as long as the promises that have already been made are honoured, again leaving the pension promise intact.

Third, employers are permitted, at any time, to change the terms of their defined benefit plans prospectively. If an employer finds that its DB plan is "too rich" for it, and not necessary in the labour market, then it is free to amend the terms of the plan in respect of future years of service. This is no different than changing the wage/salary component of the compensation package going forward, and does not break the commitments it has made to its employees and pensioners regarding their past years of service.

Fourth, for federally-regulated plans there are measures available that would permit the employer, under certain conditions, to deviate from the standard funding rules. These measures are permitted in the PBSA, and are referred to as the Distressed Plan Workout Scheme (DPWS). Among other conditions, the employer must obtain approval for the deviation from those most affected by any change to funding, namely the plan members. Approximately a year ago Finance Canada sought the views of interested parties on allowing employers to avail themselves of the DPWS without being required to declare financial distress. At that time, CFP agreed that more flexibility was warranted, and supported the objective of the amendments under consideration. That is still the case today. If that initiative has come to fruition, it has not been apparent to CFP. If an employer sincerely believes that its DBP is not

financially sustainable, then the appropriate course of action would be for it to demonstrate that fact to its plan members, and come to an accommodation with them that would permit it to meet its commitments without imperiling the future of the firm.

In their book, "The Third Rail", authors Leech and McNish describe the process of reforming certain public-sector DBP plans in New Brunswick.[9] They note that the plans were under considerable financial stress, that the seriousness of the situation was acknowledged by government leadership, plan management, and plan members as represented by public-sector unions. These parties came together and negotiated reforms that were considered by them to be necessary and to be capable of putting the plans on a sound financial basis, with give and take shown by all parties. Though the DPWS did not apply in this instance[10], the process followed in New Brunswick mirrors that intended by the DPWS. The New Brunswick example shows that accommodations are possible among parties who share common interests. It is unfortunate that the "shared-risk" legislation that has been introduced in New Brunswick appears to misread the lessons of that process. Rather than relying on parties to come to a solution of a shared problem, the legislation permits imposition of pension plan terms that disregard past commitments, without the requirement to seek approval of those most affected. By far the better approach is to utilize the framework of the DPWS that is already contained in the PBSA.

CFP would expect that if DBPs are truly "unsustainable," then there would be several instances of voluntary plan termination, and instances of employers seeking temporary funding relief under terms of the DPWS. The consultation paper offers no evidence of the alleged unsustainability.

It is a myth that defined benefit pension plans are unsustainable.

Conversion of DBP to TBP is a radical departure from the legislative approach taken up to this point. What considerations, then, are behind the proposal to permit conversion of DBP to TBP? Clearly it is not being done out of concern for DBP members, as conversion adds uncertainty to their financial future, and opens them up to an increased risk of smaller pension payments than contracted, as described above. Figure 1 is telling. It demonstrates clearly that going-concern funding obligations are less onerous – and potentially substantially less onerous – than are solvency funding obligations. A plan that is fully-funded on a going-concern basis can have a solvency shortfall of twenty percent or more. If

[9] Leech and McNish, "The Third Rail", McClelland and Stewart, 2013
[10] The DPWS applies to federally-regulated pension plans.

solvency funding obligations are lifted, an employer may enjoy years of contribution holidays, rather than be required to make special payments. With these financial incentives offered by TBP, DBP plan members can only hope that the good-will of their employer, and its natural desire to avoid a confrontation with its own employees and retirees, will keep the pensions that have been promised intact without a fight.

DBP members, including pensioners, need government rules to insist that commitments are to be honoured. They should not have to rely solely on the employer's good will to deliver their promised pensions.

An Ipsos Reid survey conducted in June of 2014 bears this out[11]. This study found that while a substantial proportion of Canadians (44%) recognize the difficulty employers may have in providing pensions for their employees and pensioners, many more — more than nine in 10 Canadians (94%) – agree that employers should live up to the commitments they have made to pensioners and employees.

And Canadians are clear that they expect their Government to make sure this happens: 92% agree that in developing a new pension framework, the federal government should ensure that companies honour the commitments made to pensioners and employees.

If a poorly crafted TBP framework permits employers to abandon the commitments they have already made to the members of their DBP plans, then Canada may well see the end of defined benefit pension plans. This would happen not because honouring the DBP commitment would be an unsustainable proposition, but because government rules would have put in place financial incentives that were too enticing for employers to resist. As the DB pension promises are broken, and in particular when the increased risks are realized by pensioners in the form of lower pension payments, then pensioners will know that government has broken faith with them.

[11] (http://ipsos-na.com/news-polls/pressrelease.aspx?id=6545)

2.5 Conversion of DBP to TBP would be seen as Government facilitating the abandonment of the Pension Promise, and adding to senior poverty

Retirees who are members of DB plans have completed their lifetimes of employment. These individuals have no recourse to recoup any loss of pension through other means. They are not able to re-enter the labour force; they are not able to find some additional source of income that has eluded them up until the time of pension loss. Retirees are uniquely vulnerable to any reduction in their pension income. To be sure, a younger individual who suffers a job loss faces difficulties, but at least he or she has the opportunity to seek income elsewhere. An active employee has the option to pursue alternative employment if the new total compensation with a lower pension benefit is not to their liking.

Retirees are looking to government to put in place pension rules that will give assurance that the pensions that had been promised to them will be delivered. In other words, they look to government to do what is necessary to secure for them the pension amounts that have already been promised to them. These promises have been the cornerstone of their financial planning for the later years of their lives. Further, because they have accrued these pension benefits during a lifetime of employment, access to other avenues of financial planning have been restricted. Potential RRSP contributions have been limited by the existence of their promised pensions. Because the government has curtailed savings opportunities for those with promised pensions, it is all the more important for government to support the promises made to them.

DBP pensions are not so lucrative that a reduction in them would leave the pensioner well off. Annual pensions are typically well below thirty thousand dollars. Even a small reduction would be a significant hardship to the lifestyle of the pensioner, and might force a formerly self-sustaining individual onto the social safety net. There is a marked disparity between those that have a DBP and those that do not with regard to their reliance on the social safety net. 15% of those with a defined benefit pension plan collect the Guaranteed Income Supplement compared to as many as 50% of retirees without one.[12]

It would be a sad irony if a government which decries the fact that Canadians are ill-prepared financially for their senior years at the same time facilitates forced reductions to the retirement incomes of those Canadians who believe their pension plans had prepared them well.

[12] As reported by McMahon and McQueen, Macleans, 3 June 2014, citing a Boston Consulting Group study of 2013.

2.6 Honouring the DBP Pension Promise within the TBP framework

The DBP pension promise is contracted on an individual basis. The individual plan member is told what his or her pension will be. The pension promise pertaining to one plan member is not contingent on the pension promise pertaining to other plan members. Each individual has the expectation that his or her pension promise will be honoured, independent of the choices made by others. The consultation paper rightly points out that different groups may have different interests. Even within a group that might be considered to have reasonably homogeneous interests, differences may exist. The consultation paper also indicates that conversion to DBP can only be done with consent, though there is no discussion on what would constitute consent. Flowing from the overriding objective that the pension promise must be kept, and from the observation that the promise is contracted at an individual basis, the TBP framework must incorporate the principle that **no DBP plan member can be converted to a TBP in respect of the service that he or she has already provided to the employer without that individual's informed consent.**

No DBP plan member can be converted to a TBP in respect of the service that he or she has already provided to the employer without that individual's informed consent.

In the case of retirees at the time of conversion, this principle would encompass the entire working lives for that employer. For active members, it would encompass the years of service provided up to the point of conversion. The TBP would be rolled out for those wishing to have their past service covered by the TBP. New employees, who bring no previous pension promise from the employer to the table, could be enrolled in the TBP as a matter of course.

3. Other Elements of the TBP Framework

The TBP framework is a network of inter-related parts. The comments below are offered within the context that the framework will adopt the principle that individual choice is to be respected. In particular, that a member of a DBP will be permitted to remain in the DBP if he or she so chooses.

3.1 Governance and Administration

Three processes must be considered.

Initiation	This process "kicks off" the establishment of the TBP, and identifies those parties which will determine the parameters of the plan.
Definition	This process contemplates the development of the plan text through negotiation, and the ultimate ratification of the plan text by the members of the plan.
Administration	This process describes the day-to-day operation of the plan, including putting into effect the measures described in the plan text.

Each process is discussed in the following sections. The discussions separately address the instance where a TBP is proposed for a workplace where no legacy pension plan exists, and the instance where it is proposed that a TBP replace the existing workplace pension plan (the conversion scenario). In the former instance, there are no retirees; there is no pre-existing pension commitment to employees or pensioners; there are no beneficiaries. The employer's task is to establish a TBP whose terms are acceptable both to the employer, and to its employees.

The latter instance is much different. There are employees and pensioners who have accrued benefits under a pre-existing pension plan; and there are beneficiaries. The employer's task is to determine which of its existing employees and pensioners/beneficiaries wish to convert their accrued benefits into the terms of the proposed TBP, and to devise a TBP plan that would be acceptable to both the existing employees and retirees as well as new employees. It is assumed in this instance that new employees would automatically be enrolled into the proposed TBP.

3.1.1 Initiation

(a) No Legacy Pension Plan

In this instance there are no pre-existing pension commitments with which the employer must concern itself. The initiation process starts with a decision by the employer to embark on the task of developing a TBP. The form of that TBP is a matter for the definition phase. As the TBP would form an element of the total compensation package offered to employees, the employer would likely find it advisable to involve the same processes as it has previously used in setting other terms of compensation, such as negotiations with unions.

(b) Legacy Pension Plan Exists

In this instance, the desired objective is a TBP that is acceptable to all plan members, including existing employees, retirees, beneficiaries, and the employer. To develop such a plan each group should be represented in the definition process. The consultation paper is correct in observing that not all groups have the same interests, and the disparate interests of each must be effectively represented. As a guiding principle, there must at the outset be a determination of how many groups have a stake in the process, where the members of each group can reasonably be expected to have similar interests. For instance, it may be necessary to have representation from each union to which employees belong. Further, the interests of beneficiaries other than retirees, such as surviving spouses, may be different from the interests of retirees themselves, warranting separate representation.

Regarding the choice of representatives for negotiating on behalf of their respective interest group, one can imagine that a union is best suited to do so for its members who are employees. When there exists an established group whose mandate is the protection of the pension interests of retirees, it is likely best suited to negotiate on behalf of retirees, and possibly for other beneficiaries as well. But even in this case, pensioner groups have memberships that typically make up the minority of the entire retired base.

It will be necessary to establish, in legislation or regulation, the process that would be followed to determine the organizations and individuals which would be empowered to negotiate. As an example, legislation could authorize the Superintendent to appoint the negotiating representatives for each of the interest groups. Alternatively, the courts may be relied upon to appoint the negotiating parties for each of the interest groups. In either case, representations made regarding the interest groups to be included in the negotiating process, and the organizations/individuals (i.e. “the negotiating parties”) who could represent those interest groups must be considered. Legislation should specify, at a minimum, that the interest groups are to include unionized employees, non-unionized employees,

pensioners, and beneficiaries. In appointing a negotiating party, there must be confidence that that party is capable of acting, and can be expected to act, in the interests of the group it is representing. Should no competent[13] organization/individual come forward with respect to an interest group, the Superintendent/Court should have the authority to appoint a negotiator who would be charged with representing the interests of that group.

Legislation/regulations should specify that the employer shall communicate to all employees, retirees, and beneficiaries. Such communication, at a minimum, should include:

- the employer's desire to establish a TBP;
- a generic description of a TBP;
- the employer's intentions regarding the conversion of any legacy pension plans[14];
- a description of the process that will develop the plan text; and
- an invitation to inform the Superintendent or the Court of the member's views regarding the party that the member believes should represent his or her interests in the negotiation process.

It is important to recognize that the interests of employees and retirees may intersect, but they do not always coincide. For example, a relatively new, and younger, employee could well be faced with student loan debt, mortgage payments, the expenses of a young family, and an expectation that his or her work life will be lived in many locations with little chance to accumulate many years of service towards any workplace pension plan. The retiree, on the other hand, has already lived through those years of debt, and knows exactly how many years of service underpin his or her pension benefits. When faced with a choice of increased employee pension contributions on the one hand, or reduced pension benefits on the other, one can imagine how the retiree would opt for the former, and the employee would opt for the latter.

Retirees and employees cannot form a single interest group, and cannot be represented by the same negotiating party.

[13] By "competent" is meant that the Superintendent/Court determines that the party is capable of acting, and can be expected to act, in the interests of the group.

[14] For instance, as proposed in section 2, the employer would indicate that any member of a legacy pension plan would be allowed, if he or she desires, to convert their DB accrued service to the prospective TBP.

Once the interested parties and their respective negotiating parties have been identified, the definition phase can begin.

3.1.2 Definition

The objective of this process is the development and ratification of the TBP plan text.

The plan text should include all plan provisions that could have an impact on the ability of the plan to deliver the target benefit.

The plan text should include those items listed at page 11 of the consultation paper. That document should also include a description of the target benefit and the conditions for receipt of the benefit, the funding policy and the investment policy. It should also include the level of representation on the administrative body for each interest group.

(a) No Legacy Pension Plan

Where there is no legacy pension plan in place, the employer would be expected to use the same processes it uses for determining other terms of compensation.

(b) Legacy Pension Plan Exists

The TBP pension legislation should stipulate that the reasonable costs incurred by the negotiating parties as a result of their duties in the development and ratification of the plan text will be reimbursed by the employer. Specifically, the costs should not be covered, in whole or in part, by the resources of any existing or future pension plan sponsored by the employer. Among the reasonable costs to be reimbursed would be those incurred by a negotiating party to gain needed expertise, which would include both legal and actuarial counsel, so that it can meet its obligations to its respective interest group.

In general, the legislation/regulation should not specify the terms of the plan text; this determination should be left to the negotiation/ratification process. However, in some instances it will be important for the rules to provide minimum requirements. These are discussed in the subsections below.

Once the negotiating parties are identified and an agreement is reached among them, each interest group represented at the negotiations must ratify the agreement, as is done in collective bargaining arrangements. The legislation, or its regulations, should specify:

- the minimum information requirements to be provided to plan members (including beneficiaries) so that they might be capable of making an informed choice;
- that it is the duty of the employer to ensure that the information is made available to all plan members. Typically, it is only the employer who has the contact information for all plan members. The legislation/regulations should indicate that it is the responsibility of the employer to deliver the information regarding the negotiated agreement, such information provided by the negotiating representative for that group. It is not sufficient that the employer have the duty to inform, as stated in the consultation paper. The negotiating representatives must agree that the information provided by the employer accurately, fairly, and fully describes the plan. Alternatively, the employer could be required to provide the contact information for all plan members in an interest group, and leave it to the negotiating party to impart the information.
- the measure of acceptance that would be deemed to ratify the proposed agreement by that interest group. Positive acceptance should be required. That is, acceptance would not be inferred by the absence of a predetermined level of rejection, i.e., 'negative option', as is specified in the PBSR currently for some purposes. It is, of course, hoped that a negotiating party can effectively represent the interests of its members. However, this can only be tested if there is a requirement for a positive choice from the membership. Further, with negative option models, the ultimate outcome may be more a result of the inability to reach all individuals with an effective message than it is a reflection of the desires of those affected individuals. CFP suggests that an agreement would be considered accepted by the interest group if a simple majority of votes cast are in favour.[15]
- that ratification of the plan text is obtained if, and only if, each interest group accepts the terms of the plan text. In this way, the interests of all parties can be honoured. There will not be an

[15] Throughout this submission it is assumed that an individual plan member is given the option to move to the TBP, or remain in that member's existing legacy plan, for all the reasons discussed in section 2. The 50%+1 threshold for ratification is of those members who have chosen to move to the TBP, or who subsequently have entered the TBP as a term of their new employment with the employer. Those who choose to remain in their legacy pension plan would have no say on the form of the TBP because they will not be members of that plan.

instance where one relatively small group has unacceptable and damaging terms imposed on it through the collective weight of other groups who do not share its interests.

3.1.3 Administration

Whether or not there was a legacy pension plan in place prior to the TBP, the same considerations for plan administration pertain.

The consultation paper proposes a Board of Trustees to carry out this function. CFP agrees with this approach, and proposes that the level of representation of each interest group on the Board would be determined in the definition process, and documented in the plan text. CFP agrees that external experts could be a valuable resource for the Board. However, only those representatives of the interest groups should be permitted to vote. In this way, only those with a direct financial interest in the outcome of administrative decisions would have a say. This condition should be a legislated requirement.

The roles, responsibilities, and compensation of the Board should be set in the plan text. Hence, they would be the subject of negotiations. Legislation/regulations should specify the minimum roles and responsibilities for the Board, including:

- to provide oversight regarding payment of pensions and collection of employee contributions, employer contributions, and employer's payment of normal costs;
- to ensure compliance with legislation and its regulations;
- to approve the report to the Superintendent regarding the funding status of the plan;
- to put into effect those measures specified in the plan text, as necessary, to bring the plan to its required funding levels, in compliance with the funding policy;
- to approve the annual audited financial report pertaining to the pension plan;
- to oversee the investment portfolio in compliance with the investment strategy; and
- to recommend, as necessary, changes to the plan text.

CFP agrees that the Board's role is not to amend the terms of the TBP benefits or contributions, though the Board should be permitted to make recommendations in this regard. Any change to the contribution/benefits package as set out in the plan text would be subject to the same negotiation process as was used in the initial set up of the TBP, and subject to the same requirements for ratification.

The plan text should specify that the Board has a fiduciary duty to plan members, which would include active employees, deferred pensioners, retirees and other beneficiaries.[16]

3.2 Funding Policy

In attempting to rationalize why solvency calculations would not be used to set funding levels, the consultation paper makes a surprising statement: "[b]ecause the target benefit is not a guarantee, solvency valuations, which are based on a termination scenario, do not appear necessary."

Solvency valuations are not necessary for funding purposes only because the objective of the TBP is to deliver the target benefits assuming that the employer remains in business. If the objective was to deliver the target benefit even when the plan is terminated, then solvency valuations would be necessary for funding purposes. It is from the objective of the TBP, and not from the fact that benefits are not guaranteed, that it follows that solvency valuations are not required for funding purposes. This is the fundamental difference between the pension promise of a DBP and a TBP. For all the reasons discussed in section 2, if DBP conversion is to be forced on any individual, then the funding requirements proposed in the consultation paper are wholly inadequate. This is because the conversion, together with the proposed funding requirements, leave the pension promise that he or she earned over a lifetime of work unattainable, particularly in instances of plan termination.

CFP agrees that a properly constructed funding policy must incorporate a factor for adverse deviation (PfAD). As noted above, the lack of same is at least in part responsible for the sudden and persistent underfunding of pension plans following the financial market events of 2008. No matter what model of pension plan, and no matter what its stated objectives, a factor for adverse deviation is necessary to help the plan meet its objectives in hard times.

The size of the factor should be a subject of the negotiation process that sets up the TBP. The figures mentioned in the consultation paper are a low starting point. Figure 1 illustrates that if a TBP were to terminate, then the plan would be incapable of meeting the target unless the factor incorporated in the funding target was in the order of 30%. CFP agrees that a higher risk profile of the investment portfolio

[16] At one point in section 4.1, the paper proposes that the Board of Trustees would have a fiduciary duty to the "plan". At another point, it proposes a fiduciary duty to the "plan members". CFP assumes that the first statement was a misstatement, and that the intention was to propose a fiduciary duty to plan members.

would call for a higher buffer factor. Additionally, the length of time a plan would be permitted to remain underfunded, also a proper subject of negotiation, should influence the quantification of the factor. The longer the time, the greater the need for a larger factor, and vice-versa. CFP recommends that a minimum factor of 10% be required by legislation/regulation. Ultimately, it should be left up to the negotiation process to determine the value of the factor, within that constraint. Over time, experience with a TBP will be instructive to the choice of factor that proves successful at limiting the time during which a plan would be incapable of meeting its objective. Periodic negotiation among the parties concerning the parameters of the plan would permit adjustment of the factor as circumstances warrant. Establishing a minimum factor of 10% should not be taken as a signal that 10% would be an effective safeguard in all circumstances. Rather, it should be taken as a signal that anything less will surely open the plan and its members to unacceptable risks to achievement of the target. There should be no reason to expect that all plans would utilize the same factor for adverse deviation.

The paper also mentions a "probabilistic" approach to setting funding targets. As the paper notes, "there are no professional actuarial standards for the probability test". CFP is in no position to offer an opinion on what would constitute a properly designed probabilistic methodology. Having said that, CFP has no objection to such an approach being adopted, providing all parties can agree to its parameters through negotiation.[17]

Whether the going-concern valuation is done on a "closed group" or "open group" basis should be a matter of negotiation. CFP has no objection to either approach, as long as the affected parties can agree to the approach.

Comprehensive valuations should be done at least annually. Both going-concern and solvency valuations should be done, and plan members should be made aware of the results. Going-concern valuations indicate the extent to which a plan can meet its obligations should the plan operate indefinitely; solvency valuations do the same in the case of a plan wind-up. In both cases, all plan provisions should be included in the valuations. Both valuations are instructive to plan members, and indicate to them, over time, the likelihood that the target benefit will be realized. For instance, the member may conclude that the plan is reasonably healthy, and therefore likely to meet objectives, should the sponsor continue, but that the target is in doubt should the sponsor falter and face insolvency. Both signals are important to the plan member, and will be an important input into the

[17] "Agreement" encompasses the conditions discussed in section 3.1.2

individual's financial planning. These minimum requirements should be specified in legislation/regulations.

If the events of 2008 illustrated anything, it was that pension plan performance can vary widely even over a short time. The sooner corrective action can be taken, the better. Consequently, it would be essential to the task of the Board of Trustees that information pertaining to the performance of the plan be made available on a timely basis. CFP is aware that a reasonable approximation of the funded status of a plan can be completed in short order. Though the specific time intervals between approximations can be a matter for negotiation, and ultimately documented in the plan text, CFP proposes that regulations would stipulate that approximations should be made available to the Board of Trustees no less frequently than monthly, and that comprehensive valuations should be made available to the Superintendent and plan members no less frequently than annually, and within three months of the plan year-end.

3.3 Contributions

CFP agrees that the contribution regime should be fully described in the plan text, and its parameters would be determined in negotiation, subject to agreement by all parties, as described in section 3.1.

Contribution triggers should also be determined by negotiation, but legislation/regulations should specify minimum contribution triggers as follows:

- Contributions should commence as soon as the plan's assets fall below the going-concern liability calculation, including the factor for adverse deviation.[18]
- In addition to normal costs, contributions cannot cease if doing so would result in plan assets being below the going-concern liability, including the factor for adverse deviation.

3.4 Benefit Structure

[18] A similar minimum condition can be specified for the "probabilistic" model.

The categorization of benefits in the consultation paper is very problematic. It is premised on the notion that some benefits ("ancillary") are less worthy of protection than are other benefits ("base"). Indexation and spousal benefits are two cited for lesser protection.

Consider the hypothetical case of a pensioner who receives $1500/month in pension payments, where that amount is comprised of $1400 in "base" benefits, and $100 in "ancillary" benefits. Also assume that the decision has been made that a reduction of $100 in benefits is required, given the performance of the plan and given consideration of other possible adjustment mechanisms. Whether the pensioner loses $100 from his base benefit, or $100 from his ancillary benefit, the net result is the same. The value of the $100 to the pensioner does not vary depending on the label, whether base or ancillary, put on the amount.

It is a myth that some benefits are more worthy of protection than others.

Regarding indexation, it is not clear what amount would be considered for "ancillary" treatment. The longer a pensioner lives, the greater is the proportion of total pension payment that is derived from indexation. As an example, for a plan that provides an annual indexation increase of 2%, after 10 years 16% of the pension payment derives from indexation; after 25 years 38% derives from indexation. For this hypothetical example, the indexation for the year would be 2%. If "indexation" is taken to mean the total proportion of the pension payment that derives from indexation, then older retirees will face greater risk, by virtue of the less security afforded to indexation. If "indexation" is taken to mean indexation benefits starting from the time at which indexation benefits are reduced, then the younger retiree will face greater risk than the older retiree. In either case, a challenge to the stated principle of intergenerational equity is created.

That spousal benefits should be considered ancillary suffers from two additional problems. First, it appears not to understand how spousal benefits are derived; and second, it would put in place perverse incentives that would work against the natural desire to protect the financial welfare of one's surviving spouse.

When an employee retires, he or she is asked to make an option regarding spousal benefits. If the spousal option is chosen, the monthly payment is set and, upon the death of the plan member, the spouse will receive over her or his remaining life a monthly payment, typically less than the payment

received by the living plan member. If the spousal option is rejected, a monthly payment larger than one determined for the spousal option is paid. Upon the member's death, payments cease. The employer relies on actuarial advice in setting the various payment levels. No matter which option is chosen, the expected value of the benefits provided, over the entire retiree base, is identical. The employer is indifferent to the option chosen. The options do not vary in their overall value; they differ only in the means of delivering the value, and the timeframe over which they are delivered. Neither option is of more value to the individual, in strictly monetary terms, than the other. Neither is less deserving of protection than the other. There is no reasonable basis on which one might determine which is "base" and which is "ancillary".

But consider the incentives established if spousal benefits are considered ancillary, and therefore subject to greater risk of reduction. At the time of the new retiree's choice, with the understanding that the monetary value of the two options are identical but the security of the "no spousal option" is stronger, the rational retiree will choose the "no spousal" option. One has to question whether it is sound public policy to give an incentive to retirees to place their spouses at greater risk in the eventuality of their death. This is the perverse incentive that a base/ancillary distinction creates.

Finally on the matter of spousal benefits, signaling these out for lesser security clearly puts beneficiaries at a disadvantage to all other plan members. If such a measure is contemplated among the measures that might be taken, it is even more necessary that beneficiaries must be granted the status of a group whose interests must be separately represented in the negotiation and ratification processes.

This last point regarding spousal benefits is a special instance of a more general problem created by differentiating between base benefits and ancillary benefits, and providing greater protection for the base benefits. The problem is that it exposes subgroups of plan members to varying levels of risk, the level of risk being determined by the proportion of ancillary benefits specific to each subgroup. For instance, the subgroup comprised of the surviving spouses of deceased plan members, under the model that treats spousal benefits as ancillary, is open to more risk than is the subgroup comprised of those that opted for the "no spousal" option. If changes in benefits – either positive or negative – are to be realized by plan members differently, as would be the case under the ancillary/base model, then a dynamic of competing interests is created. This dynamic would have to be accommodated by ensuring separate representation at the negotiating table and on the Board of Trustees, and would inevitably make for a more contentious negotiation process.

It is possible that at the time that an increment to benefits is granted due to the strong performance of the plan, it is also decided that that increment would be the first to go should reductions be necessary in the long run. This would be documented in the plan text, given consent by all negotiating parties and ratified by the corresponding interest groups. This is the only exception to the general rule that there should be no attempt to identify base and ancillary benefits for purposes of establishing different levels of benefit security.

There should be no attempt to identify base and ancillary benefits for purposes of establishing different levels of benefit security.

3.5 Funding Deficit Recovery Plan

CFP agrees that a deficit recovery plan must be established at the outset of the TBP, and recommends that it be included as part of the plan text.

Legislation should require the inclusion of a deficit recovery mechanism including, at a minimum, those parameters set forth in the consultation paper. The legislation should permit that the recovery plan would be developed in the negotiation process that establishes the TBP, subject to certain minimum standards specified in the legislation or its regulations. If agreement cannot be reached among the parties on the recovery measures and their priorities, then the minimum standards would be included in the recovery plan. The minimum standards set out in legislation/regulations should include:[19]

- The first priority for deficit recovery would be through increased employer contributions, up to the negotiated limit established for employer contributions. The limits should be expressed in terms of both amounts and timeframes;
- The second priority for deficit recovery is to be pursued only once the first priority has proven insufficient to bring the plan to full-funding, which includes the going-concern liability plus the PfAD. The second priority is to increase employee contributions to the plan, within the

[19] Standards are provided in the context of a PfAD funding model. Similar standards could be articulated for the "probabilistic" model.

constraints, if any, set in the plan text which limits employee contributions in terms of amounts and timeframes;[20]

- The third priority for deficit recovery is to be pursued only once the first two priorities have proven insufficient to bring the plan to full-funding (as defined above). If agreement on the amounts and distribution of reductions cannot be agreed upon, then a unique reduction percentage will be applied across-the-board, sufficient to bring the plan to full-funding.

As long as the plan text documents the deficit recovery plan, and the plan text is approved through the negotiation and ratification processes, then there is no need to seek additional acceptance by the plan members; the Board of Trustees should be empowered to implement the plan.

As a general rule, deficit recovery should not be delayed or postponed. Consequently, the Board should not wait until the PfAD has been depleted. Rather, action should be taken as soon as there is an indication that the buffer is being diminished. If in the judgment of the Board, however, it is determined that the depletion may be the result of temporary circumstances unlikely to have a lasting effect, say no longer than two years, then the Board may hold off on recovery measures. In any event, as soon as the buffer is completely depleted, no matter the Board's judgment on whether the underfunding might be corrected without recovery measures, the recovery plan must be put into effect.

3.6 Funding Surplus Utilization Plan

A surplus utilization plan should form part of the plan text, and be set out in the text at the inception of the plan. It would, therefore, be subject to ratification by all interested parties.

The details of the plan would be derived in the negotiation process, subject to minimum requirements set out in legislation and regulations. The legislation should require that a surplus utilization plan be created as part of the plan text, list those items which, at a minimum, should be included in the plan, and prescribe minimum standards for these items. Legislation should require that the surplus utilization plan include for both ongoing and termination scenarios:

[20] The plan text could include, for example, that additional contributions would be shared by the employer and employees according to some pre-established formula, such as a 50-50 sharing. However, if agreement cannot be reached, then the measures provided here would be the default.

- the trigger for surplus utilization, defined as the condition that must be met before distribution of surplus can be, but need not be, undertaken;
- a cap on surplus utilization, defined as the condition which, when met, requires that surplus distribution must cease, though distribution could be halted before that condition is met;
- a description of all measures and their order of priority;
- approval process; and
- entitlement to the surplus.

Regarding the trigger, legislation/regulations should define the minimum surplus that could be considered for utilization. Any surplus short of that amount must be retained in the TBP. For plans whose funding target is set as the going-concern liability plus a PfAD, the surplus would be defined as the market value of the plan's assets in excess of that funding target.

Surpluses should be utilized with caution. It is unhelpful to all interested parties, including the employer, if surpluses are used one year, and in the near future it is found that a shortfall is growing, calling for measures to cut benefits or increase contributions. To build certainty and stability in the TBP, there should be a bias towards permitting surplus utilization only if there is a very strong likelihood that the plan will not subsequently, even in the long term, be running a shortfall.

The legislated minimum trigger should take into account that liabilities and assets can vary over time, and may swing to some significant degree. As the PfAD is intended as a buffer against swings, the surplus could be expressed in terms of the PfAD. For instance, the minimum amount to trigger consideration of surplus distribution could be expressed as a multiple of the PfAD amount. Consideration should also be given to the eventuality of plan termination. As discussed above, the solvency valuation is the relevant calculation when determining the ability of a plan being wound-up to meet its target obligations. Of course, the solvency valuation too can vary from year to year, and this variability should be taken into account. Accordingly, CFP recommends the following minimum condition for surplus utilization:

> Surplus utilization can only be considered by the Board of Trustees if the market value of the plan's assets exceeds its going-concern liability by at least the greater of:
>
> 1. Three times the product of the plan's going-concern liability and the PfAD; and

2. The difference between solvency liability and the going-concern liability, augmented by the PfAD. That is, the trigger would be no more than (1+PfAD)*(Sl – Gl), where Sl is the solvency liability of the plan, and Gl is the going-concern liability.

For defined benefit plans, the *Income Tax Act* caps the allowable surplus at 25%. If the surplus for a TBP is defined in terms of the going-concern liabilities incremented by the PfAD, then the minimum trigger for surplus utilization may not be reachable without violating the *Income Tax Act*. The inconsistency would not lie with an overly aggressive trigger, but rather with the use of the going-concern liability plus PfAD as the basis on which to measure the "surplus" for purposes of the *Income Tax Act*. CFP is cognizant that this consultation contemplates only changes to the *PBSA* and its regulations. The issue of surplus utilization, however, draws in the terms of the *Income Tax Act*. CFP recommends that The solvency valuation for a TBP should be used as the basis for determining the surplus for purposes of the *Income Tax Act*.

The solvency valuation for a TBP should be used as the basis for determining the surplus for purposes of the *Income Tax Act.*

Legislation/regulations need not list potential surplus utilization measures, such as those noted in the consultation paper.[21] It should be left to the negotiation process to list and prioritize the measures that the interested parties consider appropriate.

As long as the Board of Trustees undertakes surplus utilization measures in accordance with the surplus utilization plan, no additional approvals would be required. Should the Board of Trustees believe that the circumstances faced by the plan warrant adoption of other measures, or in a different priority, then they should be required first to change the plan text. Any change in plan text would require the ratification process discussed in section 3.1.

3.7 Disclosure and Communications

[21] Section 3.4 of this submission notes CFP's objection to the notion underlying the terms "base" and "ancillary". Accordingly, they should form no part of a surplus utilization plan.

As described in section 2.6, the accrued benefits of a DBP plan member can only be transferred to a TBP upon informed consent of that plan member. To obtain consent, each plan member must be provided with a description of the parameters of the plan. In addition, the risks to the TBP pension target should be explained, and compared to the risks facing the DBP pension promise. Though the employer should have a duty to provide this information, it is not the only source of information on the subject. Section 3.1 describes the role that should be played by those representative**s** negotiating on behalf of the groups that have a stake in the TBP. It also describes the need for the employer to act in concert with those representatives to ensure that the required information is made available to all plan members.

CFP agrees that those items listed in the consultation paper should be provided to all plan members. In addition, the information that the paper proposes be provided to the regulator should also be made available to any plan member, upon request.

Solvency valuations are a source of information pertinent to the plan member, and pertinent to the security of the target benefit. The plan member must concern himself or herself with the likelihood that the target benefit will be delivered should the employer continue in business, and also be cognizant of the risk to the target benefit should the plan be wound up. No proper assessment of these risks is possible without an understanding of the solvency valuation. Accordingly, the plan administrator should be required to provide to the plan members the conclusions from the annual solvency valuations, together with an explanation of what they represent.

3.8 Conversion of Pension Plans to Target Benefit Plans

Section 2 of this submission describes the harm to DBP plan members, and others, that would follow from the conversion of a DBP to a TBP. Should an individual DBP member nevertheless choose to join a TBP, then that option should be open to the individual upon his or her informed consent.

It is in no way acceptable that the pension benefits already earned under the DBP pension promise should be made subject to the riskier proposition of a TBP absent the individual plan member's informed consent.

3.9 Individual Termination

The promise of a TBP is a concerted effort, subject to many conditions, to deliver the target benefit described in the plan text. The surplus that a plan may enjoy from time to time should be used, first and foremost, as a buffer against future events that may otherwise make the target difficult to achieve. With the exception of plan windup, no plan member is entitled to the surplus that may exist in the plan at any time. It should be considered as belonging to the plan, and not to any individual member. As discussed in section 3.6, withdrawal of surplus may be appropriate in some circumstances, and may – but not necessarily – result in lasting benefits to plan members. Should an individual terminate his or her membership in the plan, then that member is entitled to no more than the target benefit appropriate to his or her service.

Should the plan be in a deficit situation, then individual termination amounts should be as described in the consultation paper. If the commuted value of the full target benefit were to be provided to an individual in this instance, a damaging incentive would be created. The incentive would be for an individual to withdraw from the fund if there was doubt that it could be brought to full funding over a reasonable period of time. Withdrawing the full benefit from an underfunded plan worsens the funding for all plan members remaining, encouraging even more withdrawals. For the security of all remaining in the plan, termination values must incorporate the funding ratio as proposed.

3.10 Plan Termination and Wind-up

Three situations are considered: voluntary termination, involuntary termination, and termination of a TBP subsequent to conversion from a DBP.

3.10.1 Voluntary Termination

Voluntary termination should not permit an employer to avoid its TBP obligations. Prior to termination, the employer should be required by legislation to contribute to the plan the normal costs for the year of termination, together with any other contributions that are required of the employer according to the plan text. These latter amounts would include any additional employer contributions that would have been required by the plan text had the employer chosen not to terminate the plan. These amounts must be required of the employer at termination, otherwise the employer has a strong financial

incentive to avoid its obligations to the plan by terminating it. The costs of termination should not be borne by its plan members. The legislation should specify that any costs of termination are to be paid by the employer.

The termination value proposed in the paper is an acceptable means to distribute the assets of the plan to its members.

3.10.2 Involuntary Termination

This situation contemplates the insolvency of the employer. Those amounts that would be required by legislation/regulation to be paid by the employer in the case of voluntary termination should, by virtue of the terms of the *PBSA*, be granted the status of a deemed trust. That is, those amounts should not be considered the property of the employer, and not be subject to distribution to other creditors of the employer. Accordingly, they should be granted priority status in BIA and CCAA arrangements, equivalent to the priority granted today for normal costs. To put this into effect, terms of the *BIA* and *CCAA* must be amended. Conferring a deemed trust in the *PBSA* has not proven sufficient to protect those amounts to the benefit of plan members in insolvency arrangements.[22]

3.10.3 TBP termination subsequent to DBP conversion

As noted in section 2 and elsewhere, CFP is strongly opposed to the abandonment of the DBP pension promise by an employer through a mandatory conversion to a TBP. Individuals are welcome to bring their accrued DBP benefits into a TBP if they so choose, but no individual should be forced to expose himself or herself to the increased risks that a TBP represents.

Nevertheless, CFP will comment on the five-year rule proposed. It is heartening to observe that Finance Canada acknowledges that converting a DBP into a TBP may be done for purposes of avoiding the DBP obligations. CFP agrees with this. Indeed, it is probably the best means that could be made available for avoiding those obligations. Rather than, as today's rules require, terminating a DBP upon condition that it be fully-funded, the proposals in the consultation paper would permit the conversion of the DBP into a TBP. The employer need then only wait five years – the same length of time the employer would have had to bring the DBP to full funding under today's *PBSA* – and then terminate the TBP with minimal, if any, financial obligations attached. It is all the more enticing a strategy given that**,** over that five year period**,** the employer would be subject only to the going-concern funding obligations, rather than the typically more demanding solvency funding obligations.

[22] See, for instance, the recent Aveos decision of the Quebec Superior Court

The consultation paper appears to be premised on a belief that reducing a plan member's benefits, relative to the pension promise made, is acceptable if it is done for reasons of "sustaining" the pension plan, rather than for reasons of avoiding DBP obligations. Quite apart from the inability of any party to look into the heart of the employer to fathom motivations, the fact is that plan members are equally hurt no matter what the motivations might have been. Forcing plan members to give up their accrued DBP benefits is not acceptable, regardless of the motivation of the employer. If the existing DB plan creates a financial challenge for the employer, then the DPWS is the correct way to address the situation, because it does not jettison the DB pension promise.[23]

In no sense does the five-year rule "provide assurance to plan members and retirees that those plans seeking conversion to a TBP are doing so to preserve the sustainability of the plan".[24] This is a naïve assertion, at best. The TBP proposals do not contemplate any demonstration by the employer that the plan is "unsustainable". Rather, the employer need only choose to convert the DBP into a TBP. As section 2.2 points out, that decision may well be driven by the financial incentives offered by the conversion. If this is done without individual consent, DBP plan members will be hurt.

Employees and retirees of a DBP see the potential for conversion to a TBP to be an enticement to abandon DBP obligations. The five-year rule in no way diminishes that enticement. Though extending the rule to a much longer period may be helpful in encouraging an employer to rethink the strategy, it would not remedy the real problem. The real problem is the ability to convert a DBP to a TBP; that is, to replace the DBP obligations with the more lenient TBP obligations, and thereby avoid established commitments.

Conclusion

A target benefit pension plan can be a useful tool for providing employees with much needed security for their retirement years. However, forced conversion of an existing defined benefit plan will have the opposite effect. Because the pension promise of a DBP, which is that the promised benefit will be available even if the employer should become insolvent, is much different than that of a TBP, involuntary conversion will break the pension promise made to each DB plan member. The

[23] See also section 2.4
[24] Section 4.11 of the consultation paper

commitments that have already been made to employees and pensioners will not be honoured. Provided that each defined benefit plan member retains the option to remain within his or her DBP, the target benefit framework outlined in the consultation paper, and developed more fully in this submission, will be a valued contribution to enhancing retirement income security.

Appendix: Member Organizations of the Canadian Federation of Pensioners

Air Canada Pionairs

Bell Aliant Pensioners' Association of Newfoundland & Labrador

Bell Pensioners' Group

Catalyst Salaried Employees & Pensioners Association[25]

CC Retirees Organization[26]

DuPont Invista Pensioners Association of Canada

GENMO Salaried Pensioners Organization[27]

International Air Transport Association Retirees

KODA Retirees Association[28]

MacMillan/Bloedel Weyerhauser Salaried Employee Club

Municipal Retirees Organization Ontario

Novartis/Ciba Retirees Group

Nortel Retirees Protection Canada

Ontario Northland Pensioners Association

Regroupement des Employés Retraités White-Birch Stradcona

Rio Algom Salaried Retirees

Store and Catalog Retirees Group

Society of Energy Professionals Pensioners' Chapter

Stelco Salaried Pensioners Organization

Yellow Pages Pensioners Group

[25] Registered name is CSEP Advocacy Association
[26] Salaried retirees of Chrysler Canada
[27] Salaried retirees of GM Canada
[28] Pensioners of KODAK Canada