



Canadian Federation of Pensioners
Advocating on Behalf of Pensioner Groups & Their Members

Revitalizing the Defined Benefit Pension Plan

Response to the

Ontario Expert Commission on Pensions
February 2007 Discussion Paper,

***Reviewing Ontario's Pension System: What are the
Issues?***

September 2007

CANADIAN FEDERATION OF PENSIONERS

REVITALIZING THE DEFINED BENEFIT PENSION PLAN

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1 The Canadian Federation of Pensioners (CFP)

The Canadian Federation of Pensioners (CFP) was formed in 2005 to bring together retiree groups for the purpose of exploring pension plan issues from a pensioner point of view. Currently CFP is focusing on the need to improve the long term security of defined benefit pension plan (DB plan) pensions by:

- Participating in government and other forums that have been formally established to review issues and challenges with DB plans; and
- Identifying pensioner issues with the current Canadian legislation for when a business is sold or merged, declared insolvent, bankrupt or is forced to wind-up, and the pension plan is underfunded.

CFP is a young and growing organization which currently has seven actively involved pensioner groups whose DB plans are sponsored by a wide spectrum of businesses and whose individual members encompass retired corporate officers, senior executives, management, non-management, union and professional employees. In addition CFP liaises with 13 other retiree groups which, together with the 7 active groups, represent the interests of approximately 100,000 DB plan pensioners.

CFP welcomes the decision by the Ontario Minister of Finance in November 2006 to establish an Expert Commission on Pensions (OECF). Since the active CFP member groups are primarily concerned with defined benefit pension (DB) plans, it is encouraging to see the OECF assign a high priority to the principles for maintaining and encouraging this type of plan.

2 Retirees are Important Stakeholders

Pensioners did not have a direct role to play in the development of current pension plan legislation. Nor were pensioners appropriately represented by other stakeholders in ensuring that retirees interests and needs were met. One result is a distinct lack of recognition and status for pensioners in the current Pension Benefits Act and related regulations.

The maturing of many existing DB plans means that the pensioner population is increasing to the point that it often equals or exceeds the number of active members. Therefore it is crucial that retirees be recognized as key stakeholders and equal to the active members in all aspects of ensuring that DB plans are financially healthy and able to meet their required pension benefit obligations both currently and for the long term.

2.1 Key Issues Affecting DB Plan Retirees

- Pensioners, now more than ever, recognize the risk to their retirement savings and spending power should their occupational pension plan ever have to be wound-up with a deficit. *If and when such an unfortunate situation occurs it is important to consider that, unlike most active members, very few pensioners would have the time it*

would take or be able to find workplace opportunities in order to replace their lost spending power.

- Furthermore, the Ontario Pension Benefit Guarantee Fund (PBGF) in its current form would likely not provide adequate compensation to make up for more than a modest portion of any lost spending power for many pensioners.
- Pensioners are increasingly concerned about the financial well-being of their pension plan. CFP member groups, such as the Stel Salaried Pensioners Organization (Stelco retirees), have first hand experience with former employers being put under the Company Creditors Arrangement Act. Others, such as the Slater Steel salaried pensioners have witnessed their pension plan being wound-up with a significant deficit.
- Some CFP groups, such as the DuPont Canada/INVISTA retirees, have learned first-hand how corporate restructurings and changes in ownership can leave pensioners with little or no communications from employers on the financial condition of the DB plan which then requires they must physically retrieve such information at the office of the pension plan regulator.
- It is reasonable to assume that the PBGF is financially weak and certainly could not sustain a large plan failure or a string of smaller underfunded pension plan wind-ups in the near future. Plus, the current payout formula and amounts for the PBGF have never been updated since inception in 1980 which means that as time goes by it replaces less and less of the spending power that pensioners lose with the wind-up of an insolvent plan.
- Retirees are not required to be experts on DB plan administration nor should it be expected of them. They must instead rely on government legislation and regulations, the fulfilment of these regulations by the plan sponsor, the monitoring performed by the regulating agencies, and the professional expertise of the plan administrators and fund managers.
- While this is perhaps implicitly understood by some pension plan stakeholders, nowhere is it reflected in legislation or in the mandates of relevant governing bodies for professionals. For example, the prime objective for a pension regulator should be declared in legislation to be to protect the interests of pension plan members, former members/pensioners and other beneficiaries. A similar requirement for pension plan professional actuaries is needed from the Canadian Institute of Actuaries.

2.2 Retirees are Ready and Able to Participate

As outlined above, pensioners have become increasingly aware of the inadequacies of the current DB plan model and the PBGF. As a result they can bring a unique and very important perspective to the DB plan discussion tables and are forming advocacy groups to assure stakeholder recognition and for direct representation at the discussion tables for

bringing about changes. CFP, for its part, works to bring retiree advocacy groups together in order to build and share a growing knowledge base and expertise on DB plan issues and challenges and how they might be resolved.

Pensioners, for the first time, have knowledgeable representation and a growing desire to be heard and to participate in resolving key pension plan issues and in improving the DB plan model.

3 Key DB Plan Revitalization Considerations

3.1 Recent Consultations and Briefs

CFP has reviewed the OECP February 2007 discussion paper from several points of view and in particular that of current DB plan pensioners who have significant concerns and issues. At the same time CFP is mindful of other DB plan stakeholder communities and has therefore strived below to reflect a balanced position in proposing changes and solutions which we believe are in the best interests of everyone. In addition to referring to the OECP discussion paper, CFP has also reviewed the:

- May 2005 Finance Canada consultation paper, Strengthening the Legislative and Regulatory Framework for DB Pension Plans Registered under Pension Benefits Standards Act, 1985 along with the published stakeholder responses;
- DB plan studies and consultations undertaken by the provinces of Quebec and Alberta;
- Other relevant and important studies and positions, such as the Bank of Canada position that emphasizes the importance of DB pension plans in benefiting the Canadian economy and capital markets; and
- The Canadian Institute of Actuaries' DB plan position paper, Prescription for Canada's Ailing Pension System, issued June 2007.

3.2 DB Plans and the Canadian Retirement Income System

David Dodge, Governor of the Bank of Canada, in his speech, *Economic and Financial Efficiency: the Importance of Pension Plans*, in November 2005 to L'Association des MBA du Québec, concluded that "Canada's pension plan system is crucial to our future, not only because it will sustain us in our retirement, but also because it supports the efficiency of our markets and our overall economy in important ways. Defined-contribution and defined-benefit pension plans, RRSP's, and the CPP and QPP all have a role to play."

Mr. Dodge noted that an important part of the pension system, private DB plans, is in decline. There are several reasons for this, not least of which are problems and issues identified by the previously mentioned Finance Canada May 2005 consultation paper. As

a result of this consultation, temporary regulations have been implemented by some pension plan regulators in order to address some of the more urgent shortfalls.

Many companies are attempting to cut costs purportedly to appease investors and/or to stay competitive on a global scale by cutting or eliminating the package of benefits they are willing to provide to their employees. Although too soon to tell the impact of their actions on the buying power of individuals and on the investment power of pension funds in the Canadian economy, it is becoming increasingly clear that many groups of employees, upon retirement, will have considerably less financial security than they counted on in their pre-retirement planning.

It is difficult to assess the likely impact on the retirement income system of the decline in the number of DB plans. Beyond this, the impact of these trends on the Canadian capital markets is unclear.

There is evidence that Canadians are joining the work force later, retiring earlier, and living longer. In addition, businesses frequently use age of retirement in planning downsizing initiatives.

The above suggests that questions need to be asked about the adequacies of the existing retirement income system and the role that DB plans should play in ensuring that current and future retirees will have adequate spending power in the years ahead.

3.3 Importance of DB Plans to the Canadian Economy and the Financial Market ¹

A report to G-10 deputies published in September 2005 emphasized that pension funds have already become the largest institutional investor class among G-10 countries. It also noted that retirement savings and the related capital flows will have an increasingly important influence on financial markets.

There is a need for long-term investment in critical infrastructure to support Canada's future production capacity. And there are pools of DB plan capital that are available for very long-term investment. It is critical to Canada that this source of capital continues to accumulate and be invested and thus contribute to the sustained growth of the Canadian economy and the maximization of the spending power of future pensioners.

DB plans offer the least long term risks to the Canadian financial system. Compared to defined contribution pension plans, DB plans mitigate the risk on returns by pooling the assets of all contributors and thereby protect the ability of a sponsor to pay pension obligations, even to those plan members who retire one day after a stock-market crash or at a time when the return on long-term bonds is low.

¹ Source: 9 November 2005 speech by David Dodge, Governor of the Bank of Canada to L' Association des MBA du Québec

Financial longevity risk is also better mitigated with DB plans. This risk is absorbed by the plan sponsor – usually the employer – who is responsible for making up any shortfall that could arise from pensioners living longer than expected.

By transferring risks from individuals to pools, DB pension funds help achieve a more efficient allocation of savings – especially compared to the costs and fees associated with mutual funds that are a huge burden for RRSP owners. DB pension funds, particularly the very large ones – tend to have sophisticated asset managers and utilize sound actuarial practices. These large funds have the incentive and the ability to invest across appropriately varied asset classes. Further, they invest over very long term horizons, so they can finance large investment projects at competitive rates of return. This contributes significantly to economic efficiency by transferring risk to those investors that are best able to bear it.

The size and sophistication of large DB plans tend to lead to responsible corporate governance, contribute to market discipline and support overall market efficiency.

3.4 Potential Impact on Taxpayers & the Economy Should Pension Legislation and Regulations not be Updated

The May 2005 Finance Canada consultation paper elicited a high volume of formal responses from various sectors of the pension stakeholder community (all accessible on the Finance Canada website).

While there were widely varying opinions and suggestions regarding how to solve issues and problems, the general consensus is that significant changes are required to occupational pension plan legislation and regulations. Without these changes, the future is bleak with regard to the willingness and ability of companies to establish new DB plans.

There is an urgent need to resolve issues regarding ownership of pension plan funds and in particular surpluses. Currently, surpluses are not as prevalent as in previous years due to the recent history of lower interest rates and volatile returns on investment. In the past, carrying pension plan surpluses has helped sponsors to offset the effects of lower interest rates and downward impacts of the economy on their businesses. Uncertainty over surplus ownership encourages sponsors to fund their plans at minimum levels.

Pension plan surpluses are viewed by pension plan members and beneficiaries as very important in terms of protecting their pension benefits. When a pension plan does not have a surplus or is in a deficit position, it generates considerable uncertainty with older members as well as with retirees and other beneficiaries. This uncertainty would ultimately cause them to reduce or redirect their spending and resulting in a negative impact on the economy. Virtually all plan sponsors who responded to the Finance Canada May 2005 consultation paper implied that the unresolved issue of pension plan surplus ownership is a disincentive to funding plans in good times at levels which will provide added security in periods of economic slowdown or weak returns on assets.

In a briefing document sent to the Honourable James Flaherty from the Office of the Superintendent of Financial Institutions Canada dated February 6, 2006, the Minister was advised: “OSFI is receiving more requests by pension plans for reductions in benefits as plans look for ways to deal with increasing funding requirements. In many cases, these reductions in benefits affect both active and retired members. OSFI is prepared to work with pension plans to find reasonable solutions to funding challenges, including approving benefit reductions where we believe this would be better for plan members than plan termination.”

Unless legislation and regulations, *in all Canadian jurisdictions*, are changed, there is a continuing risk that more pension plans will fail in the future and will have to be wound up when the business of a sponsor fails. This could mean that plan members will see their pension benefits reduced. The wind-up of a large pension plan with a funding deficit could have major repercussions on the economy and at the same time could put undue pressure on governments to use taxpayers’ dollars to provide ongoing financial assistance to some plan members and/or the beneficiaries affected. Additional tax dollars would also likely be required to prop-up the already strained PBGF.

3.5 The Ontario Pension Benefits Guarantee Fund

- Retirees view the PBGF to be deficient and possibly a deterrent to adequate plan funding. The PBGF itself doesn’t appear to be adequately funded as evidenced through the need for supporting government loans. It certainly couldn’t rise on its own to a challenge posed by a number of simultaneous pension plan failures or even by one very large plan being forced to wind-up with a large deficit.
- There is the question being asked about whether or not having a PBGF leads to some plan sponsors not seriously viewing their responsibilities to properly fund their plans.
- Pensioners are concerned about the risk that the PBGF could someday be unable to meet its obligations with no assurance that anyone would be willing or able to bail out the fund.
- Another equally important issue for pensioners is the level of payout that the PBGF provides. It may or may not have been adequate when the fund was started but the payout rates have not changed. Since 1980 the Canadian Price Index (CPI) has risen 250%, which has left affected pensioners with an unconscionable loss in spending power. There is a vast difference on spending power between the benefit from a well-funded DB plan and that provided in the wind-up of an insolvent plan, even considering the inadequate supplement from the PBGF.

3.6 The Pension Plan Information Void

The Expert Commission on Pensions February 2007 discussion paper includes a section, ‘Significant changes to pension plans as a result of changes in the employment

relationship: Wind-ups, splits, mergers and insolvencies'. There have been instances recently with these types of situations whereby members and former members were not informed sufficiently, or in advance, that their pension benefits could be or would be adversely affected.

- Pension plan sponsors currently have very few requirements under current legislation for keeping members and former members informed about their plan and their individual status.
- There is provision in the Act for a pension plan to have an optional *advisory committee* established in which members and former members may participate. The functions of the committee include communicating information about the plan to its members and former members (retirees). It should be noted that an employer is not obliged to establish a committee or to include retirees.
- The current provisions were introduced during a different business and economic environment than exists today. At the time members and former members in the majority of DB plans had few, if any, concerns about the financial health of their pension plan.

Currently there is an uneasy feeling amongst retirees that the current levels of business and financial market turbulence impacting the financial health of their pension plans. This leads to increased personal stress for the individual and his or her family as DB plan pensions are most often their major source of post-retirement income.

- Compared to when current legislation was enacted, today's pensioners are growing more knowledgeable and informed on financial and economic matters as they affect their pension plan. More and more they are not content in being omitted from the process.
- Adding fuel to fire is the general lack of timely and adequate communications by sponsors on the current status and the financial health and stability of a pension plan to the stakeholders most immediately affected – the pensioners. In some instances, active members do receive information on the status of their DB plan but the pensioners have been forgotten or ignored.
- When a DB plan sponsor with publicly listed shares is taken private, there is an increased exposure to risk for the pensioners and one which they could not have foreseen. When this happens the plan sponsor is no longer required to issue financial results publicly in any form or forum and pensioners no longer have access to the financial health of the sponsor and thereby its abilities to continue to fund the pension plan.

Given that sponsors are not required to report the financial status of their DB plans to

pensioners, the only alternative means for obtaining pension plan and pension fund information is through visiting the regulator's office in person. This means that in reality the access to pension status information is difficult for most pensioners. Even more disturbing is that the data is invariably out of date.

Pensioners should not have to accept the added stress of keeping abreast of the current financial condition of their pension plan upon which they depend so heavily for their post-retirement income.

RECENT RETIREE EXPERIENCES

- Members of STEL (Stelco Salaried Pensioners) know only too well the lasting stress that results from a lack of information being provided by their pension plans sponsor. During the 1990's, the sponsor, without informing members and former members either before or afterwards, received permission from the regulator to take contribution holidays for their salaried plans under Regulation 5.1 ("too big to fail"). This quickly led to the plans falling into significant solvency deficit positions resulting in a potentially disastrous situation for both pensioners and the PBGF when the sponsor's business was placed under creditor protection.

Note: There are other issues raised by the above sequence of events which are above and beyond a lack of communications. No business is "too big to fail". Did the sponsor knowingly take into account that the PBGF was there as a fall-back should the plans ever have to be wound-up with solvency deficits?²

- Slater Steel pensioners have encountered severe financial issues which were exacerbated by a lack of communications. During the business failure of Slater Steel, retirees were unaware of the details of the sale of the Hamilton Specialty Bar Division; the fact that the pension plan had been in a solvency deficit position for several years; and that the purchaser was not assuming the pension plan liabilities.³ It didn't help matters that pensioners had previously been told at the time of retirement that their pensions were vested and 'guaranteed' for life.

While the business was in creditor protection and then in bankruptcy over a period of two years, pensioners continued to receive their full pensions. To make matters worse, in the end the court determined that some had been overpaid and these individuals were not only to receive a reduced pension but also were forced to pay back the overpayments. During this time there were no communications by any party to the pensioners. As a result they were not aware and could not therefore plan for the possibility that some might have to pay back a portion of their received pensions and that all were facing a potential reduction in their pension entitlements.

² See Section 3.5

³ Retirees also received no prior notice that their life insurance and medical benefits had been cancelled and only found out when they went to the pharmacy to have drug prescriptions filled.

3.7 Funding Issues

3.7.1 Surplus Ownership

A review of the responses to the Finance Canada May 2005 discussion paper on DB plan issues leads to the conclusion that the number one problem is what plan sponsors call the asymmetry issue. Other stakeholders refer to it as the surplus ownership issue.

Regardless of what it is called, there is a consensus within the pension stakeholder communities that unless or until the issue is resolved, employers are apt to do whatever they can to minimize pension plan surpluses. Pensioners view plan surpluses as a highly desirable feature that helps ensure the continued solvency of their plan and as a hedge against adverse deviation caused by unforeseen changes in the economy, financial market or an employer's business cycle.

3.7.2 Current Imposed Funding Limits

As a result of sudden drops in interest rates and other financial market issues in the early 2000's a majority of DB plans went from having solvency surpluses to being faced with significant solvency deficits. Some of this was also due to a change in rules and tables for how funding solvencies are determined.

But a lot of the change in financial status can be attributed to rigid limits imposed by the Income Tax Act on funding when there is a surplus and the maximum for the allowable surplus. Had the rules been different, sponsors would have had an opportunity to fund for larger surpluses which could have provided a better financial 'cushion' for their DB plans.

It has become readily apparent to most stakeholders that the current imposed limits need to be changed. Currently every plan must adhere to the same criteria for carrying a funding surplus.

Employers and the plans would benefit from being able to build up a funding surplus according to the economic and business cycles they operate in. A business that services hospitals could be relatively immune to the economic and business cycles and therefore could fund its pension plan without having to rely on carrying a large surplus. On the other hand, an automotive parts manufacturing business would benefit during the bottom of the business cycle by being able to use the plan surplus versus having to make contributions from current operations.

3.7.3 Funding Plan Amendments

An issue whenever there are solvency deficiencies is the impact that plan amendments have either in creating the deficit in the first place or in making a deficit larger.

This may not be a problem when the employer's business is financially healthy but there are currently insufficient criteria in current regulations to ensure the adequate funding of

plan amendments and to have new plan amendments voided in order to protect existing pension benefit entitlements when deemed appropriate.

3.7.4 A Major Root Cause for Several DB Plan Issues

As long as a DB plan remains fully solvent, key issues such as an employer's business being placed under the Company Creditors Arrangement Act, the Bankruptcy and Insolvency Act, or when a business is re-organized, split-up, merged or sold, have little or no impact on the vested rights of the plan members and pensioners. Similarly, issues surrounding plan amendments will be much easier to deal with when the plan is fully solvent.

It is solvency funding deficiencies that create many of the current issues with DB plans and create problems for regulators and other stakeholders. Current legislation sets too low a standard by allowing solvency funding deficiencies to develop and by providing sponsors with up to five years to eliminate them. As well, the five year period that regulations allow for eliminating every solvency deficit sends the wrong message to sponsors by signalling that deficits are a normal or acceptable business practice.

4 Solutions for Revitalizing DB Plans

4.1 Strengthen the funding requirements to maintain full solvency

As indicated in Section 3.7.4 above, the current widely accepted notion that it is acceptable for a pension plan to have a solvency deficiency sets the wrong expectations. Furthermore, it has a negative impact on pension plan administration, including the determination of investment policies and the setting of formal funding plans.

There is a need to ensure that employers fund their pension plan on a continuous fully funded basis. In practical terms, it actually means that employers should be encouraged to establish a funding level that is in excess of full solvency funding.

Excess funding is necessary in order to provide for a reserve fund^{4 5} as an option for the employer to draw upon during periods when the economy is having a negative impact on the business, when interest rates or returns on investments are falling, and so on.

⁴ Currently any over-funding is referred to as a 'surplus'. In reality, the only time a fund surplus can be determined is after full wind-up of the plan. CFP recommends that the amount of over-funding identified above be named a *solvency reserve fund*.

⁵ The June 2007 Canadian Institute of Actuaries, Prescription for Canada's Ailing System, proposes a *pension security trust* for each DB plan. This is similar in intent to the CFP proposal of a *solvency funding reserve* as outlined in more detail in Sections 4.1.2 and 5.1.2 below.

4.1.1 The Advantages of Continuous Full Solvency Funding

Continuous full solvency significantly reduces the magnitude or eliminates completely many current issues affecting DB Plans, such as:

- The vulnerability of DB plans to significant and/or unforeseen changes in interest rates and rates of return on assets.
- The need for sponsors to source special funding to eliminate solvency deficiencies.
- The number of incidences of DB plans being closed to new members or being wound up.
- Where a DB plan is involuntarily terminated, there will be much better assurance that any adverse affects on the plan's obligations to its members, pensioners and other beneficiaries would be minimal.
- Providing a more stable source of post-retirement income to the benefit of pensioners and other beneficiaries as well as to the economy as a whole. That is, pensioners and other beneficiaries will be more willing to utilize their full spending power without worrying about how much of this income to set aside and save in case their pension plan has to be wound up with a significant solvency deficit.
- The extent to which regulators will have to monitor plans in general and provides for an opportunity to flag any plans having financial difficulties sooner and before they fall into a solvency deficiency position. There would also likely be fewer plans requiring direct regulatory intervention.
- CFP takes the position that over time, with the implementation of the measures needed for continuous full funding, the Ontario PBGF will eventually become redundant (see Section 9). It would eliminate the need to establish a PBGF in any other jurisdiction in Canada that also adopts these proposals.
- Facilitates the transferring of members between pension plans and facilitates partial wind-ups in jurisdictions where they might still occur. Adoption of the proposals in other Canadian jurisdictions would facilitate inter-jurisdictional transfers of pension accruals when employees move to a new employer.
- The number and severity of current issues regarding the funding of plan amendments.

4.1.2 The Benefits of a Pension Plan Reserve Fund

The reserve fund fundamentals are described in [Section 5.1.2](#). In addition to its main purpose of ensuring the pension plan is fully solvent at all times, the reserve fund will:

- Eliminate current “assymetry” issues for the sponsors. Any excess pension plan assets would be transferred currently to the reserve account. The reserve account would be funded as required to keep it within a prescribed minimum and maximum funding range.

Should the reserve fund exceed the range maximum, the excess would belong to the party or parties that are directly funding the reserve and they would advise the regulator and Canada Revenue Agency as to how the excess is to be disbursed and request the regulator’s approval to proceed.

- Eliminate current misunderstandings or misconceptions regarding pension plan ‘surpluses’ in the current DB plan model.
- Eliminate, along with implementation of full continuous solvency funding, any notions that pension plan solvency deficiencies are acceptable risks.
- Provide a funding ‘cushion’ that will assist the pension plan sponsor in better ensuring that its pension plans are fully funded throughout the full business cycle as well as in periods of low interest rates and returns on plan assets.
- Provide sponsors with an option to increase payments to the reserve in order to have available the funding needed for financing future plan amendments. This would help ensure that new plan amendments will not create a solvency or reserve fund deficiency requiring special payments following implementation.

4.1.3 Continuous Full Solvency = Plan Stability

The Canadian Institute of Actuaries recently issued a brief containing a list of “Ten recommendations to heal Defined Benefit pension plans”⁶. Their objective, which CFP fully agrees with, is to encourage a sustainable environment for fully solvent DB plans.

Continuous full solvency creates a much more stable environment for the benefit of all pension plan stakeholders, not the least of which is the **plan sponsor**.

- At first glance, some sponsors might be inclined to conclude that achieving full continuous funding could be a financial burden. But if, as the CFP proposal suggests, this objective may be reached over a reasonable period of time, counted in years, the financial burden would be made manageable.
- Once the objective of continuous full solvency is reached, the reserve fund will significantly contribute to sustaining the plan at this level of funding. The ‘smoothing effect’ of the reserve fund will facilitate overall financial planning for the sponsor.

Continuous full solvency along with adequate reserve funds should provide comfort to shareholders, credit-rating agencies and the investment community.

⁶ Canadian Institute of Actuaries’ Prescription for Canada’s Ailing Pension System, June 2007

- Continuous full solvency along with an adequate reserve fund will foster improved governance and asset management practices. This could include exploring opportunities to establish unique investment policies for the reserve fund.

By far the other major benefactors of a more stable and financially secure DB plan environment are the **plan members, pensioners and other beneficiaries**. These are undoubtedly those who have the most to lose should a pension plan with a solvency deficiency fail and be wound-up. Worries about the potential loss of pension income can lead to all sorts of personal and financial stresses. To have full continuous solvency backed up by an adequate pension reserve is therefore of the utmost importance for these individuals.

Also to be recognized is that a stable DB plan environment will **benefit the economy and the capital markets** by encouraging sponsors to keep their current DB plans and will improve the potential for new plans being created.

4.2 Other Considerations

4.2.1 Change the Funding Limits

As mentioned above, the funding limits imposed in the Income Tax Act (ref. Section 3.7.2) are too restrictive if there is to be a sufficient funding reserve⁷.

4.2.2 Introduce Indexation Requirements

Canadian society is very cognizant of the impact that increases in the cost of living can have on individuals' standard of living. In the national retirement income system, Old Age Security, the Guaranteed Supplement plus Canada/Quebec Pension Plan benefits each have an indexing component.

But when it comes to DB plans, indexing is a very mixed bag. Some DB plans offer indexing which may be full or only partial. Some plans provide for conditional indexing based on the health of the plan and/or the employer. Other DB plans have no provision for indexing in the text of the plan. However some of these employers have stated to plan members that they will consider voluntarily amending their plans from time to time to provide increased benefits to offset increases in the cost of living.

Pensioners, whose DB plans have no provision for indexing, are very aware of how easily their spending power is eroded over time even with current relatively levels of low rates of inflation. Other pensioners, who rely on ex gratia indexing, are left high and dry if the plan sponsor chooses not to implement an increase in benefits.

The introduction of indexation requirements for DB plans is long overdue. The question is to what extent should retirees be protected from having their DB plan pensions eroded?

⁷ See also Section 5.1.2

Full indexation could be very damaging to the pension plan and the sponsor in times of high inflation.

That said, Canada appears to be in a period where inflation is being well-controlled and everyone is hoping that it stays that way for the long term. It is more feasible now to implement indexation as a necessary component in the DB plan model.

Some current plans have introduced a form of indexation that includes a ceiling or maximum amount for applying in a given fiscal period. That way, the actuaries have a better handle on the long term funding requirements for the plan. This is not entirely satisfactory to pensioners but is vastly superior to having no automatic indexation provisions included in the text of the plan.

4.2.3 Information Technology and Improved Reporting

Currently pension plan status information is only provided to the regulator anywhere up to 12 months following the plan year-end. Today, society and business demand quick and inexpensive access to ever more detail information which has resulted in the development and exploitation of new information technology which didn't exist when current pension legislation was introduced. This technology can be used to prepare and disseminate more information on the status of the plan more quickly and thereby benefit pension administrators, the regulator, plan members and pensioners.

4.2.4 Empower the Regulator

It is expected by plan members and pensioners that the regulator should be given the necessary regulatory powers needed to proactively ensure that sponsors fully comply with pension legislation and regulations.

Pension legislation should clearly give the regulator the responsibility to ensure that the best interests of plan members, pensioners and other beneficiaries are always taken into account when carrying out its function.

4.2.5 Independent Plan Administration Review

Some aspects of the administration of a pension plan are subject to annual accounting audits. But there is no requirement in current legislation or in professional guidelines to have any of the remaining functions, e.g. actuarial studies, reviewed by qualified and independent professionals. And this is in the day when even the external auditors for public companies are subject to having their work reviewed by other qualified professionals.

The regulatory agency should be given the power to conduct a full review of the pension plan. These regulatory reviews should be done on a random sampling basis and definitely utilized where it is evident that a pension plan or its administrator or the sponsor is having difficulties. Such a review could reduce the potential for a pension plan having to be wound-up or if forced to be wound-up, could help to minimize any deficit.

5 Steps to Achieving a Revitalized DB Plan

5.1 Raise the Bar for DB Plan Funding Requirements

5.1.1 Continuous Full Funding of the Main Pension Plan Fund

An established pension plan fund should always be fully solvent. Administrators should be monitoring the financial performance of the plan's investments as well as its costs. Corrective action should be taken immediately whenever the plan incurs a solvency deficiency.

5.1.2 Establish a Reserve Fund

In order to sustain continuous full funding, a reserve fund is required for each plan. Reserve fund minimum and maximum funding levels are required for each pension plan.

- The reserve fund would be the source of funding required to keep the main pension account fully funded at all times. Normally all funding and special payments to the pension plan would be made to the reserve fund. Excess funding in the main account would be transferred to the reserve fund.
- The *minimum funding level* for the pension reserve would be the amount required to be set aside for adverse deviation, determined by the plan actuaries in a manner similar to the new Québec requirements. The pension reserve account must never be allowed to fall below the minimum.
- The plan actuaries would also establish a pension reserve *maximum funding level* for each DB plan. This would include consideration for the short and medium outlooks for Canada's economic and financial cycles, the relative maturity of the plan, the financial forecasts for the sponsor's business, and so on.
- The current funding limits specified in the Income Tax Act would no longer be required⁸.
- The reserve fund is to be considered part and parcel of the whole pension plan and protected in law as such. Funds in excess of the upper reserve limits in the reserve fund may be withdrawn but only with the prior agreement of all the parties who have contributed directly to the reserve with appropriate notification to the regulator and the Canada Revenue Agency.

⁸ See Section 3.7.2

5.2 Update Pension Plan Reporting Requirements

5.2.1 Expand and Accelerate Reporting to the Regulator

Annual reporting to the regulator will be expanded to include audited financial statements for the reserve fund.

For the benefit of the regulator and to communicate effectively with members, pensioners and other beneficiaries, annual reporting would be done in two stages.

- Plan administrators will provide a provisional key indicator report on the financial health of the pension plan within 45 days of the end of the plan year. The reporting would include the level of funding in the reserve fund and any special payments made or owing.
- Final full reporting on the status of the pension plan will be done within six months of the end of the year under report, including a triennial (or more frequent) actuarial review.
 - This reporting would include an analysis on the appropriateness of the reserve funding minimum and maximum levels
 - Part of the reporting package should include details on the current pension plan funding policy and an updated funding plan.
 - A report is required to be submitted on the controls and governance in place regarding total pension plan administration and any changes since the last reporting.
 - A triennial (or more frequent) statement from the plan sponsor attesting to the adequacy of the procedures and controls in place for administering the pension plan along with an actuarial opinion on the adequacies of the pension reserve minimum funding levels.
 - The regulations governing the above would have to be expanded to include a requirement for an independent opinion on the actuarial review results if adequate requirements* are not developed and implemented as a Canadian Institute of Actuaries practice requirement.
*Similar in idea and intent to the accounting audit reviews conducted under the auspices of the Canada Public Accountability Board.
- When a formal actuarial review is not required, an actuarial certificate is to be submitted similar to the requirements now in place for DB plans regulated by Québec.

5.2.2 Provide a Proactive Pension Plan Regulatory Environment

CFP is pleased to note that the OECF has commissioned a research project, *Analysis of the Financial Services Commission of Ontario*. A pension regulator, regardless of the jurisdiction, is required to operate within the parameters of the respective pension legislation and is reliant on the government of the day to provide an adequate budget for fulfilling its functions.

CFP is concerned that the Ontario regulator currently has neither the mandate, nor likely the budget, it needs to monitor proactively and effectively the status of pension plans in today's business, economic and financial environment. Ideally the regulator should be monitoring not only the pension plan but also be cognizant of the ability of the plan's sponsor to fund the plan as required, particularly for plans which could be underfunded and large plans where a failure could be devastating for the members, the economy and possibly for the government.

CFP will be very supportive of any recommendations forthcoming from the research project which would increase the mandate of the regulator and allow it to be more proactive.

5.2.3 Keep Pensioners Better Informed

It is absolutely essential that employers be required to inform pensioners in detail on a regular and timely basis regarding the financial status of their pension plan. It is unreasonable to expect each pensioner or group of pensioners to have to retrieve such information on their own and in person from the regulator. Consider the pensioner living in Thunder Bay and having to travel at personal expense to Toronto to learn about the status of his or her pension plan.

This would include the sponsor or plan administrator providing access to the same information that is submitted to the regulator and within the same timeframes. In addition, there should be means by which members, pensioners and others are informed in detail throughout the year regarding plan amendments which are more than purely administrative in nature.

There are a number of ways in which the information could be easily disseminated to the pensioner. More and more retirees have access to e-mail and the internet and for them the employer would not have to create and distribute hard copy reports by postal service.

Note: The provision of information to pensioners on a timely basis would largely eliminate the currently perceived need amongst some retirees that they need to be given a direct role in the administration of their pension plan if that is the only way they can be kept aware of the status of their plan.

6 Implementation Considerations

6.1 Resolve the Pension Fund Surplus Issue

Most stakeholders agree that the number one priority right now is the need to deal with the issue of *surplus ownership*. The above proposals for revitalizing the DB plan precludes there being a surplus in the main fund for the plan while the plan is still active. It furthermore resolves the ownership of any amounts in the pension reserve in excess of the maximum allowable.

However this still leaves a potential issue with plan surpluses in place prior to implementing the revitalized DB plan model. If the plan text currently does not clearly state which party or parties are entitled to access the surplus, the employer will have to reach an agreement with the members and pensioners in this regard, even if it requires formal arbitration.

In addition, legislation should require that the text of a new plan must include a clear and unequivocal statement on ownership of the funds, including any ongoing excess funding or any surplus at the time a plan is wound-up.

6.2 Establish a Transition Period

Full implementation of the proposed enhanced DB plan model will require a *transition period in order to give sponsors time to fund the reserve account*. When The Netherlands implemented the requirement for continuous full solvency of DB plans it allowed sponsors several years in which to comply with the full requirements.

6.3 Consider Incentives to Encourage Increased Funding Levels

Providing in legislation that the parties who contribute directly to the reserve fund the right to access any over-funding could be viewed by sponsors as an incentive to fund the reserve account sooner rather than later.

More incentives, such as the following, would encourage more funding.

- One possibility might be to give Ontario registered DB plan sponsors the ability to opt out of the Pension Benefit Guarantee Fund (see Section 9) as soon as a pension plan's reserve account is fully funded. This would be feasible because under the above proposals, there would be no need to keep a PBGF in place for active plans once the enhancements are fully implemented.
- Finance Canada has allowed for the temporary use of Letters of Credit to facilitate sponsors making special payments to eliminate solvency deficiencies in their pension plans. Quebec in December 2006 implemented the permanent ability for sponsors to use of Letters of Credit within prescribed limits. And the Income Tax Act was amended last fall to allow for the proceeds from called Letters of Credit to be used to fund the pension plan directly.

Keeping DB plans fully solvent at all times would lead to fewer issues for sponsors' creditors plus plan members, pensioners and other beneficiaries should a sponsor ever be subject to Company Creditors Arrangement Act or Bankruptcy and Insolvency Act.

7 The Future for the PBGF

The topic of a Pension Benefit Guarantee Fund was broached in the May 2005 Finance Canada discussion paper on DB plans. With only a couple of exceptions, respondents were in agreement that a PBGF should not be introduced for federally regulated DB plans. Most respondents seemed to dwell on issues about fair and adequate funding as well as the feeling that having a PBGF acts as a disincentive to the adequate funding of DB plans, particularly if a sponsor is having business financial difficulties.

Ontario is in a different situation due to already having a PBGF in place. As mentioned earlier, the PBGF has not been a total success in that it is underfunded and in certain jeopardy should there be any big demands placed on it in the future. And many pensioners who have experienced the wind-up of their DB plan with large deficits find that the PBGF did not live up to their expectations.

CFP takes the position that the PBGF cannot continue in its current state as the problems will only worsen over time to no ones benefit. It cannot be wound-up immediately due to its inherent benefits. But over time it and with fully funded plans, it could be made redundant and eventually retired.

7.1 Proposal for Eliminating the PBGF

The gradual elimination of the PBGF could be feasible if the CFP proposals for revitalizing the DB Plan are implemented. Once a DB plan is on a continuous full funding basis along with a requisite minimum threshold level of reserve funding, any windup of that plan should result in members and pensioners receiving the full pension benefits they are entitled to without needing funds from the PBGF.

7.1.1 Interim Measures

- The PBGF needs to be updated to bring the payout formula in line with the current scale of pension benefits and changes to the CPI since 1980.
- A review should be done to ascertain the financial hardships encountered by pensioners and former members with deferred pensions whose DB plans were wound-up in the last five years with significant solvency deficits. The finding of the review would determine the extent to which the PBGF payouts made for these people need to be adjusted.

7.1.2 Allow Employers to Opt-Out of the PBGF

- As soon as a DB plan is on a continuous full funding basis, along with a requisite minimum threshold for the funding reserve, the employer would be allowed to apply to the regulator to discontinue making contributions to the PBGF.
- Once contributions are stopped, that DB plan would become ineligible for PBGF benefits.

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Canadian Federation of Pensioners
cfp1@on.aibn.com
Tel: 905-512-6246