Canadian Federation of Pensioners
2009 Pre-Budget Consultation Brief
To the House of Commons
Standing Committee on Finance
August 14, 2009

"What Federal Tax and Program Spending Measures are needed to Ensure Prosperity and a Sustainable Future for Canadians from an Economic, Social and/or Environmental Perspective?"

Executive Summary

The Canadian Federation of Pensions is a federally registered "not for profit" organization that advocates on behalf of Defined Benefit Pension Plan retiree organizations whose collective membership across Canada is greater than 150,000 citizens from all walks of life.

Over the last several years numerous reports and recommendations have been produced identifying the urgent need for pension reform. The lack of focus on this issue, until possibly the present, has inevitably resulted in a number of sponsors entering CCAA or liquidation and a continuing stream of pension plans being wound up or threatened with wind up.

Businesses can rethink and refit poor business plans, but pensioners cannot relive their years of useful employment. Honorable Members, we believe that the issue of the solvency of defined benefit plans will become a growing political issue as more and more companies seek regulatory protection in fulfilling their obligations.

The recent economic downturn has exposed the fundamental weakness in the nation's elderly support system. The continuing failure of "too large to fail corporations", like General Motors, Nortel, Chrysler, etc., has verified the fallacy of this oft-spoken concept. Corporations continue to attempt to mask the true viability of their Pension Plans. For example, the Chief Financial Officers of seven major Canadian businesses are recommending that existing pension fund benchmarks be skewed so much that an actuarial solvency deficiency could be viewed as an actuarial surplus. In many instances, corporations which are unable to make their pension liability payments are also at great risk to their own financial solvency.

The Canadian Federation of Pensioners strongly recommends that the House of Commons Finance Committee give serious consideration to the following recommendations:

1. Support urgent modifications to key federal legislation, e.g. the Pension Benefits Standards Act, the Companies Creditors Arrangements Act, the Bankruptcy and Insolvency Act, the Canadian Business Corporations Act, the Income Tax Act to recognize retirees as key stakeholders and to ensure that pension benefit entitlements receive maximum protection should a pension plan sponsor fail financially with the plan being under funded.
2. Support the establishment of a pension advisory group with a "sunset clause" to assist the Government in its current initiative "Strengthening the Legislative and regulatory Framework for Private Pension Plans subject to the Pension Benefits Standards Act 1985". It is recommended that this committee be composed of knowledgeable and skilled individuals from Actuaries, Corporations, and Government, ***with at least 25% of its members from the retiree community***.
3. Continue to provide Federal Government leadership and encourage the Provinces in their current individual plan reviews to update their plans so as to be coordinated and consistent on a national basis.

Introduction

The Canadian Federation of Pensions (CFP) is a federally registered "not for profit" organization that advocates on behalf of more than fourteen (14) Federal and Provincial Defined Benefit retiree organizations whose collective membership across Canada is greater than 150,000 citizens from all walks of life.

The private pension plan system is at a critical abyss and a major paradigm shift in approach is required to avoid wholesale dehumanization of many of our most fragile citizens. We urge the Committee to encourage and support the work undertaken by the Department of Finance this year and ensure that the Department's initiatives are legislated in a timely manner. The ever increasing number of individuals reaching retirement age and the results of economic turmoil will continue to exacerbate an unacceptable situation unless prompt corrective action is taken.

Background

Finance Minister Flaherty released a discussion paper in January 2009 "Strengthening the Legislative and Regulatory Framework for Private Pension Plans Subject to the Pension Benefits Standards Act 1985" Many consultation papers were subsequently received as listed on the Finance Canada web site and subsequently nationwide hearings were held under the Chairmanship of Ted Menzies the Parliamentary Secretary to the Minister, which saw many Canadians voiced their support for urgent Pension Regulatory Reform.

Since then, the following two Temporary Solvency Relief Measures have been passed to the benefit primarily of corporations without providing any additional security to Pension Plans.

1. Solvency Funding Relief Regulations 2009, 29 May 2009
2. Air Canada Pension Plan Funding Regulations, July 2009

The necessity for these two relief measures only confirms the criticality of and the need for urgent pension reform. These temporary measures do not improve the security of pensions and in fact increase significantly the risk that pensioners will be ultimately deprived of their sources of income at the time in their life when they are unable to effect replacement.

There is widespread agreement in government and with pension plan stakeholders that permanent pension plan legislative and regulatory changes are urgently required in order to remove obstacles that threaten the long term financial security for pension plan members and beneficiaries. Increasing, businesses are attempting to cut costs to stay competitive on a global scale by diminishing or eliminating the package of benefits they are willing to provide to their employees and to retirees. One of the most recent examples is Nortel Networks, but it is only one of the latest in a growing number of companies large and small. ***It is becoming increasingly clear that Canadian employees, upon retirement, will have considerably less financial security and spending power than they otherwise might have***.

Private pension plans are a key pillar in the Canadian retirement/old age income system. What are the implications to Canadian capital markets for large infrastructure projects and to other investments resulting from these changes? Combine all this with evidence that Canadians are joining the work force later, retiring earlier and living longer, and that businesses frequently use age of retirement in planning downsizing initiatives. ***No government today has a sufficient grasp of the economic and societal implications resulting from the decline in defined benefit pension plans, the increase in defined contribution plans or the number or companies which do not sponsor a pension plan***.

Balancing the Needs of Plan Sponsors, Current Members and Retired Members

Retirees cannot relive their years of employment. Contrast this with the fact that sponsors can always adjust their business plans, and active employees can always take steps to improve their pension plans or other compensation going forward. Retirees are the most vulnerable of the pension stakeholders, and legislation and regulation should reflect this reality.

A defined benefit pension plan is a promise made between an employer and its employees. The promise is that for the years of work provided, a pension – defined in advance - will be paid. In this light, any potential lessening of the integrity of a pension plan is seen to be no more legitimate than would be a retroactive reduction to the salary paid to an employee for work already completed. And the call for "balance" as is contemplated in the provincial reports is seen to be no more appropriate than would be a call for retroactive salary reductions to existing employees so that new employees might be hired, or so that the sponsor's profits might be improved.

The two Temporary Solvency Regulations have disproportionately offset any balance which may have existed and created an environment of concern and fear amongst thousands of Canadians. ***In the event of sponsor failure (even with the above relief, many sponsors have not been able to survive CCAA/bankruptcy), the Government should confirm to members and retirees that their pension income will be maintained either through sponsorship by Government Agency, a back-up insurance to cover any individual shortfall, or other financial process as appropriate.***

Pension Funding Security

Over the last several years, the issue of plan viability has not so much focused on plan surplus but rather on lack of solvency. This may largely be due to the inability or lack of motivation on the part of plan sponsors to make contributions of sufficient magnitude to achieve a 20% surplus and the restrictions imposed by the CRA. In good economic times, plan sponsors often generate significant profits to operations which many, as good corporate citizens, would contribute in excess of the current nominal 10% providing it was reasonable to do so. One of the ways by which corporations could be enticed to make greater contributions would be by:

- Amending the PBSA to require establishing a separate pension reserve fund and setting a minimum funding level for it. This minimum would be the amount required to be set aside for adverse cyclical deviation, as determined by plan actuaries' experience with plan members and retirees (based on existing economic conditions 20% - 25% would be warranted). The plan reserve account must never be allowed to fall below the minimum. The reserve fund would be the source of additional funds required to keep the main pension plan fully funded at all times. The plan actuaries, with input from plan members and retirees, would also establish a pension reserve maximum funding level for each defined benefit plan. The current funding limits in the Income Tax Act need to be withdrawn completely.
- Revising the Charter of Actuaries to ensure they are neutral agents and are responsive equally to the requirements of all stakeholders.

Solvency Measurement and Funding Rules

In times of economic turmoil there is a requirement to be able to benchmark, on a continuous basis, the financial health of defined benefit pension plans. These benchmarks not only provide an assurance to the members and retirees of the plan viability, but may also provide insight for all stakeholders as to the financial health of the plan sponsor. The most valuable of the benchmarks currently being used is the actuarial solvency ratio which is a measure of the assets to all liabilities should the plan be instantaneously wound up (CCAA/bankruptcy).

This benchmark is fully dependent on the elements used to determine future values and hence can be subject to manipulation. As a matter of fact and as mentioned earlier, this benchmark is currently under fire by some very large plans sponsors. The government should set stringent and enforceable rules such that artificial manipulation of this benchmark is restricted. ***The discount rates used to determine the value of the pension sum must be in close proximity to the rates available to obtain member and retiree annuities or equivalent long term investments. Otherwise, this measure will not fulfill its intended purpose and could end up creating a large risk that active and retired plan members would see their pension entitlements reduced should their plan be forced into wind-up due to the insolvency and wind-up of the plan sponsor.***

Pension Fund Retirement Benefit Payments

It is particularly interesting that DC plan members have the option to elect either for a life annuity or transfer to a RRSP/RIF on retirement. Generally most opt for the transfer option. Yet retired DB plan members whose plan is being terminated with a deficiency (as could happen in the case of plan sponsor insolvency) are not given the choice of transfer to RIF, or other plan, but must accept an annuity, and that has the effect of permanently crystallizing their loss.

In today's investment climate, the option to accept a transfer to a RIF might allow some of the DB losses being experienced by retirees to be recovered at a future date. And, it would provide more flexibility for a retiree to meet short term income needs that an annuity does not provide.

There are survivor issues that need to be dealt with in moving away from having only an annuity option, but those can also be accommodated in a RIF environment. Retirees making such an election need to be compelled to obtain the advice of a professional financial planner/advisor.

Another option might be to allow consenting retirees to group their funds and move them into a fund, for instance, managed by the CPP. If fund performance permitted, the pensions of retirees might increase over time, something group annuities do not.

Sponsor Bankruptcy and Insolvency

There is a need to emphasize the financial exposure of members and retirees when the business of a plan sponsor fails and the provisions of the Bankruptcy and Insolvency Act (BIA) are applied. Recent BIA amendments do provide limited creditor protection for some types of payments owed to a pension plan. But DB plans themselves are not preferred creditors even though, in many instances, they have been and are a sponsor's greatest creditor. This is anomalous in that a business can fail because it cannot meet its obligations to amortize a DB plan solvency deficit.

The forced wind-up of a DB plan having a solvency deficit can be devastating for retired members. A great many retired members rely on their DB plan benefits as their major source of income and most of them are unable to replace lost income by rejoining the workforce. Given the current economic and financial crises, the risk for forced plan wind-ups has perhaps never been higher with no certainty as to when these crises will ease and there is no guarantees that these or similar crises won't happen again in another few years.

What the Standing Committee on Finance Can Do

At this point in time there is no need to increase the funding for any government programs or to introduce new ones. What is required is for the Committee to:

- Foster all party support of the required changes in legislation in order to ensure quick passage of the proposed changes in the House of Commons.
- Pension legislation and regulations should have as a priority objective the maintenance of the pension promise that has been struck between the employer and its current and retired plan members by protecting the financial security of existing defined benefit pension plans.
- On Pension Plan wind-up, beneficiaries should have the option of other than Annuities for investing their deemed retirement savings.
- The funding limits in the *Income Tax Act* should be eliminated, because they impede prudent funding and do not provide sufficient flexibility to mitigate the potential for underfunding when investments or the sponsor underperforms.
- Any contributions and deficit amortization payments owing, but not yet remitted to the pension fund, should be deemed to be held separate from the sponsor's assets, and included in deemed trust provisions of the PBSA.
- If the amounts identified above do not bring the pension plan to full solvency funding, then the pension fund and its members should be treated as fully secured creditors.
- Legislation and regulation should allow, voluntary termination of plans *only if*:
    - The plan is fully funded at the time of termination and consistent with an evaluation of the plan conducted at the time of the proposed plan termination; or
    - There is a payment schedule that will ensure the full funding of the plan over a specified period.
- The discount rate allowed to be used to calculate liabilities for DB pension plan valuations should be consistent with the rate available on investment vehicles should a pension plan be wound up.

The Canadian Federation of Pensioners have access, through its member groups, to many professional, skilled and talented individuals (financial, pension, accountants, legal, administrative, etc.) with broad experience and who are increasingly knowledgeable about the many complex pension legislation and regulations issues currently under review by Government. We continue to be available to assist in the development of initiatives to strengthen the "Legislative and Regulatory Framework for Private Pension Plans subject to the Pension Benefits Standards Act, 1985."

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