Comments of the

Canadian Federation of Pensioners

regarding

The Pension Benefits Act Review

Manitoba

(January 2018)

21 February 2018

Introduction

The Canadian Federation of Pensioners (CFP) is pleased to provide its comments regarding Manitoba's *The Pension Benefits Act* Review. CFP is an organization dedicated to improving the security of Defined Benefit pension plans in Canada. Each of CFP's member organizations advocates for the interests of the active and retired members of a workplace DB pension plan. Collectively, the CFP member organizations represent the interests of more than 250,000 individuals across Canada.

The consultation paper covers a number of issues that the Pension Commission of Manitoba reviewed, offering recommendations for consideration. CFP will deal with two of those issues: New plan designs (Part 3) and Solvency deficiency funding rules (Part 4). The other issues under consultation are also important, but do not fall within the mandate of CFP—we thus offer no comments on them.

'Part 3 — New plan designs' suggests a new regulatory framework for target benefit pension plans (TBPPs) and shared risk pension plans (SRPPs). We begin by disputing that they can usefully be described as "types of pension plans designed to provide cost certainty with a defined benefit plan (DB plan) promise", and specifically that they can be considered as forms of DB plans. True DB plans explicitly define the benefit promised in the plan rules; TB and SR plans do not define benefits, but leave them contingent on funding availability. CFP strongly urges Manitoba to make this distinction quite clear, if they are added to its regulatory framework.

These types of pension plan are legitimate improvements for employers without any plan, or only defined contribution plans. CFP encourages these types of plans in these circumstances. But we strongly object to the ability of employers to **convert existing DB plans** to TBPPs or SRPPs; for this subverts the pension promise inherent in DB plans especially for pensioners who cannot participate in any offsetting business benefits that such transfers might provide for active employees.

In Section A, CFP provides more detail on our TBPP position. In Section B, CFP addresses each of the Part 3 discussion questions posed in the consultation paper.

'Part 4 — Solvency deficiency funding rules' deals with matters that have been recently changed in many Canadian jurisdictions, or where change is under active consideration. The paper notes that in 2017, the Ontario government proposed a number of initiatives that now form the basis for a revamped Ontario DB pension framework. CFP has participated in Ontario's consultation process since its inception, and continues to advocate for measures that will strengthen the security of pensions earned in Ontario and elsewhere in Canada.

The Manitoba consultation paper raises many of the same issues that are nearly in place in Ontario. CFP believes that the recommendations that it has made to Ontario to improve pension security in that province would prove to be of mutual benefit to pensioners and employers in all Canadian jurisdictions. We made similar representations to Nova Scotia last year as well.

In section C, CFP presents a summary of its proposal for pension funding framework reform. It is a novel solution to two persistent problems. At least in recent years, many employers with defined benefit plans have chafed at the cost of fulfilling the defined benefit pension commitments that they have made to their current and former employees. At the same time, pensioners have come to realize that those

commitments may not be honoured. Pensioners losing part of their pensions when their former employer falters is all too common. Even a cursory examination of funding statistics demonstrates that a significant proportion of pensioners are in plans that are underfunded, leaving those pensioners at risk to losses should the employer become bankrupt. CFP's proposed framework addresses both of these issues. If the pension framework is changed as CFP proposes, then employers will realize significant savings as the costs to maintain their DB plans are reduced, and pensioners will be assured that the pensions they have earned will be paid as promised. The proposal is not only fair in that it honours the commitments that have been made, it is also economically efficient in that it delivers better outcomes at a reduced cost.

In section D, CFP addresses each of the discussion questions posed in the consultation paper. The questions canvass issues that are interrelated. So that CFP can properly address these interrelated issues in a comprehensive fashion, it first sets out in section C a description of the pension policy framework it proposes. In most instances, the brief answers provided in section D are elaborated on in section C. The answers to the discussion questions must be read within the context of the framework proposal presented in section C.

The Manitoba PBA Review and the suggested pension revisions in the consultation paper build on activities in a number of other Canadian pension jurisdictions. In our submission, CFP similarly uses its previous submissions in Ontario, Nova Scotia and federally to provide our basic objectives and much of the detail that we wish to be considered as Manitoba proceeds to improve its pension framework.

A. New Plan Designs

CFP's philosophy and expectations for new pension plan designs are well covered in our submission to the Finance Canada Consultation Paper, "Pension Innovation for Canadians: The Target Benefit Plan" (April 2014), submitted on June 23, 2014. A copy is included with this submission.

CFP is heartened to see, in the very first paragraph of the Consultation Paper's Introduction, that employer pension plans are characterized as the "pension promise". The fundamental bedrock upon which all of CFP's submissions are based is that **pension promises must be honoured.** Pension reform, even in troubling financial times, must not decrease the pension security that retirees have expected as part of their total compensation while working.

Our federal TBPP submission makes the following points, which we believe are relevant to the pension reform discussion that Manitoba has initiated:

- TBPP increases the risk borne by DB plan beneficiaries
- absent established pension promises, TBPP is a useful tool
- DBPP conversion to TBPP breaks established pension promises, and harms pensioners
- intergenerational equity is undermined by the proposed conversion (accrued benefits from previous employment can be reduced so future employee and employer contributions can be reduced)
- DBPP conversion opens employers to legal battles

- there is no need to harm members of DBPPs
- DBPP to TBPP conversion would be seen as Government facilitating the abandonment of the Pension Promise, and adding to senior poverty
- honouring the DB Pension Promise can be done within the TBPP framework
- governance and administration issues need to be addressed in the TBPP framework
- TBPP funding policy must cover the possibility of plan termination and adverse financial events
- the contribution regime for TBPPs should be fully described in the plan text
- all pension plan benefits are worthy of protection
- a deficit recovery plan must be established at the outset of any TBPP, and should be part of the plan text
- a surplus utilization plan should be established at the outset of the TBPP as part of the plan text
- full disclosure of all aspects of a TBPP must be communicated to all plan members
- if DBPP to TBPP conversions are accepted (CFP does not recommend this), then the option must only be allowed upon the informed consent of each individual plan member
- individual termination of plan membership should trigger no access to any funding surplus, nor a commuted value when the plan is in deficit that does not incorporate the solvency funding ratio
- voluntary termination must require any additional employer contributions required by the plan text
- involuntary termination must include all employer contributions as for voluntary termination as a deemed trust with priority status in insolvency proceedings
- the possibility of TBPP termination after conversion from DBPP strengthens CFP's stricture against such conversions

CFP has similar concerns and objectives regarding shared risk pension plans.

B. Part 3 Discussion Questions

In conjunction with the detailed description of CFP's position in Section A, we provide capsule answers to the specific questions posed in the consultation paper.

Q1 Should Manitoba develop a regulatory framework for a new target benefit or shared risk pension plan design?

The proposed new pension plan designs can be developed, but employers should not b e permitted to convert DB benefits already accrued.

Q2 If so, should a target benefit or a shared risk pension plan framework be developed?

In the context provided in Section A, the differences between TBPPs and SRPPs are not crucial to CFP.

Q3 Should the new plan design be available to both single employer and multi-employer plans, and both private sector and public sector plans?

CFP suggests broader rather than narrower applicability of any new plan design, so that employees moving between jobs have an increased ability to consolidate their pension entitlements gained with their various employers.

Q4 Should the new plan design be restricted to unionized environments?

For the same reason as for Q3, CFP suggests no such restriction.

Q5 Should conversion to the new plan design be permitted for future benefit accruals only?

For the reasons elucidated in Section A, CFP strongly recommends that no conversion be permitted from defined benefit pension plans. Converting from defined contribution pension plans are permissible.

If the weight of comments that Manitoba receives from this consultation recommends that conversions be permitted, then CFP even more strongly recommends that such conversions be only for future benefit accruals. To clarify, this means that no pensioner will have the pension plan providing their pension benefit converted from a defined benefit to either a target benefit or a shared risk pension plan.

Q6 If conversion of existing benefits is permitted, should union or member consent be required?

CFP asserts that natural justice and basic fairness requires that any pension plan beneficiary's accrued DB benefits can be converted to TB or SR if and only if that individual gives his or her explicit informed consent. Otherwise, the original pension promise can be subverted in the normal operation of the new-design plan without any recourse by the individual beneficiary.

C. CFP Pension Funding Framework Proposal

CFP has developed the following proposal that allows significant permanent solvency funding relief for DBPP sponsors without compromising plan beneficiary pension security, in fact enhancing it. We have recently provided this proposal and rationale to both Ontario and Nova Scotia; those documents are included with this submission. We will again rely on the detailed discussions in those documents to describe our comprehensive group insurance scheme that covers all pension benefits in the rare event of plan sponsor insolvency leading to plan termination. This contrasts with the present system, put in place since the 1980s, that requires sponsors to, in essence, self-insure via solvency funding requirements against insolvency while the pension plan is in deficit (which situation leads to the near certainty of pension benefit reductions, i.e. breaking the pension promise).

Our Ontario and Nova Scotia submissions make the following points, that we believe will provide a more financially efficient and certain way of providing full pension security to plan beneficiaries whatever the financial vagaries the sponsor might endure:

General

- pension security is critical to all Canadians
- recent solvency valuation history in all Canadian jurisdictions shows persistent underfunding in spite of funding rules and regulatory oversight meant to ensure full funding
- solvency funding regularly excludes indexation, masking the true state of full-benefit funding by 25 to 30 percentage points
- many pensioners are at risk of material pension reductions should their plans be forced to wind up
- relaxing solvency funding rules will only increase pensioner risk

Objectives

- provide pensioners with a guarantee that the DB pension they earned through their working lives will be delivered to them in their retirement years, i.e. the pension commitments that have been made will be honoured
- provide DB employers with a pension framework that is less costly, and significantly so, than the current pension framework

Features

- change the paradigm for pensioner protection
- self-insuring against wind-up deficits via solvency funding is financially inefficient, often leaves a significant benefit unfunded (i.e. indexation), and ensures a deficit if the wind up occurs before the end of the amortization period allowed to retire solvency deficits
- instead, retain self-insurance for a portion of the plan's solvency liabilities, and introduce a collective insurance scheme for the balance; all DB sponsors should be required to support an insurance pool that can cover any unfunded liability for any plan that winds up involuntarily
- pensioners would be better protected, and
- sponsors would realize significant savings from the combined effects of lowering the funding target and introducing fees for the insurance pool

Implementation

- going concern funding should include a provision for adverse deviation (PfAD) to enhances the benefit security objective of the going concern funding obligation; CFP recommends a default PfAD of 25%
- lowering the solvency funding target can deliver significant savings to employers, but must occur together with
- the introduction of a Pension Guarantee Fund, fully funded by fees from all DB pension plans; i.e. no taxpayer support
- the PGF must cover all plans, all plan benefits, and without a coverage cap

- PGF fees, to ensure comprehensive coverage and to provide incentives for improved management of plan funding, would need to be based on an assessment of each pension plan's risk profile
- consideration should be given to the establishment of a third party administrator to be accountable for the continued operation of plans that would otherwise wind up in an underfunded state; this allows possible deficit recovery in the market, relieving pressure on the PGF

Impact

- improved pension security for plan beneficiaries with significant savings for employers
- detailed analysis of our complete proposal for Manitoba DB pension plans should be undertaken; our analysis for Ontario clearly indicates that only a small fraction of the savings for employers from the solvency funding relaxation portion of our proposal is required to fully fund the comprehensive PGF proposed

D. Discussion Questions

As noted above, the answers to these questions must be read within the context of the discussion in section C, which suggests a different way of providing solvency funding relief while decreasing the risk to pension plan members' full benefits. We believe that our scheme still speaks to the issues canvassed by the questions.

Q7 Are any of the above options reasonable and practical in a Manitoba context?

A7

CFP strongly recommends consideration of its comprehensive group insurance scheme described above. Some of Manitoba's specific options can be consistent with our scheme—detailed comments can be found in our answers to the next four questions.

Q8 If so, which option or combination of options described above would be most effective in balancing the different interests of plan sponsors, unions, members and retirees?

A8

CFP is adamant that "balance", especially between the interests of sponsors and plan beneficiaries, must not increase the risk to beneficiaries when a lower cost alternative is available that in fact enhances the security of their pensions—the CFP scheme.

Option 1 (eliminate solvency funding and enhance going concern funding): The actuarial bases for solvency and going concern valuations are different enough that there is no certainty that plan termination risk will be adequately dealt with by GC funding alone. The detailed comparisons between the two valuations contained in our included submissions to Ontario and Nova Scotia make that very clear. But in conjunction with the CFP group insurance scheme, this issue would be much less of a problem.

Option 2 (introduce solvency reserve accounts): With the CFP scheme, the need for such reserve accounts would be much reduced.

Option 3 (eliminate solvency funding): CFP cannot condone this option without serious additional methods of covering the increased risk to beneficiaries of plans being terminated with solvency deficits. The CFP scheme affords a financially efficient and comprehensive way of accomplishing this objective.

Option 4 (maintain the current solvency funding rules): CFP's included submissions document why this would continue to lead to catastrophic pension plan failures. The news has been full of many examples.

Q9 If a regulatory framework based on option 1 is developed, which approach or combination of approaches described under option 1 should be considered?

A9

For many years, CFP has advocated for the use of a PfAD for setting going concern funding targets (Approach B), since it mitigates the risk that fully funded plans can suddenly become underfunded, and possibly significantly underfunded, when market conditions change. CFP continues to call for the use of a PfAD for that reason. However, only by coincidence and good luck would the use of a PfAD for GC funding purposes meet the objectives for solvency funding. Because solvency liabilities can be substantially greater than GC liabilities – and this has been the case for the last several years – a plan may not be able to meet all of its pension commitments should it wind up, even if it is fully funded according to the GC+PfAD standard. Consequently, if solvency funding is eliminated or set according to a lower target, it is critical that a guarantee fund be in place so that the unfunded windup liabilities, for plans terminating involuntarily, can be covered.

Approaches A and D are mutually exclusive concepts. A assumes a shortened amortization period, D assumes an annual consolidation of deficits. CFP supports the shortening of amortization periods, because it reduces the risk that a plan will be underfunded at the same time as it winds up. CFP would support a proposal, say, that reduces the amortization period of GC deficits from 15 to 10 years. That is, a GC deficit that arises in a year must be eliminated over the next ten years, rather than 15 years. The elimination of a deficit over an amortization period has meaning only if deficits are not consolidated annually.

The Ontario government has said that it has adopted both A (shortening the amortization period to 10 years) and D (consolidating deficits). The truth is that combining the two approaches as Ontario has done has the effect of substantially prolonging the time that a deficit will persist. This is illustrated in CFP's "Comments on Reform of Ontario's Funding Rules for Defined Benefit Pension Plans: Description of New Funding Rules" dated January 29 2018, also included with this submission.

CFP is not opposed to the consolidation of deficits. However, it must be done in a way that would not have the effect of prolonging the effective duration of deficits. As shown in the document referenced in the previous paragraph, pretending to shorten the amortization period to 10 years while consolidating deficits, as Ontario is doing, triples the duration of a deficit. If, for instance, Manitoba wished to shorten a GC deficit duration to 10 years and to consolidate deficits, then the funding requirement calculated each year would have to be based on an assumed "amortization period" of no more than three years.

Approach C (solvency trigger for enhanced funding): This would "focus the mind" of sponsors, leading to better management of DB pension plans, but doing this in a self-insurance framework (the present system) is significantly less efficient than the group scheme CFP proposes.

Q10 If the 100% solvency threshold is reduced to require partial funding, is a threshold of 85% appropriate? If not, what should the threshold be?

A10

CFP recommends that partial solvency funding should continue, but with our scheme, the specific funding threshold is much less important. See also our answer to Question 9.

Q11 Are there any other reforms to the funding framework that should be considered?

A11

CFP reiterates our preference for the group insurance scheme that we espouse. It covers all the objectives to minimize required contributions, while enhancing the protection of the "pension promise".