Submission by the Canadian Labour Congress

to the

Department of Finance Consultation on a Potential Federal Framework for Target-Benefit Pension Plans

June 2014

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Executive Summary

The Canadian Labour Congress (CLC) is the voice on national policy issues for 3.3 million workers in Canada. The CLC brings together Canada's national and international unions along with the provincial and territorial Federations of Labour and 130 district Labour Councils, whose members work in virtually all sectors of the Canadian economy, in all occupations, and in all parts of Canada.

In the CLC's opinion, the Department of Finance's proposal to explore a framework for single-employer target-benefit (TB) pension plans in the federally-regulated private sector and for Crown corporations constitutes a dangerous and irresponsible step. The CLC strongly objects to permitting conversions that would allow the reduction of accrued defined benefits and the elimination of those defined-benefit liabilities. Allowing the retroactive conversion of accrued DB benefits to contingent target benefits would be offensive and profoundly unfair to plan beneficiaries, potentially placing the burden of adjustment on pensioners who are least able to manage. In a competitive environment, allowing sponsors to dispense with accrued defined-benefit (DB) plan liabilities will compel other employers to similarly rid themselves of accrued liabilities. We also strongly object to the unacceptable restrictions placed on collective bargaining as well as the trustees' role of governance that is contemplated in the consultation document. The framework's proposal to allow conversion of defined-benefit (DB) to TB plans bears the hallmark of being solely driven by consideration of the cost of DB plans for employers. The government's proposed framework for single-employer TB plans will do little to expand pension coverage for the 62% of Canadian

workers with no workplace pension plan. The CLC recommends that the government withdraw the proposed framework for target benefit plans, and it urges the Federal Government to return to its 2010 commitment to implement improvements to the Canada Pension Plan.

Introduction

The CLC welcomes the opportunity to provide input on the proposed federal framework. While we recognize the focused nature of the consultation, it raises fundamental concerns of plan beneficiaries' rights under pension legislation and jurisprudence, funding requirements, plan governance, and other core issues that the CLC believes properly form the basis for a wider debate. The consultation raises important and urgent questions, such as joint governance and solvency funding requirements for DB plans sponsored by government-backed Crown corporations and similar entities, which transcend the narrow focus of the consultation, while remaining silent on and providing contradictory and underdeveloped proposals on other matters. The CLC therefore calls on the Federal Government to convene a larger debate on the rules and regulations governing workplace pensions in Canada. We believe that a larger debate is called for, since the proposed target-benefit framework is simply one response—and we believe a narrow and mistaken one—to a larger set of challenges facing Canada's workplace pension plans.

The Conversion of Defined-Benefit to Target-Benefit Plans

The CLC strongly believes that plan sponsors must not be permitted to eliminate existing accrued liabilities by converting plans into target-benefit schemes. Converting from DB to TB plans—no matter how efficiently managed or how sophisticated the stochastic modelling—represent a **loss** of security for plan members. TB plans may strive for stable benefits, but probability-based funding or funding with a provision for adverse deviation provides no guarantee and indeed reduced

protection in the absence of the legal right to benefits earned for past service.

Allowing the retroactive conversion of accrued DB benefits to contingent target benefits would also be offensive and profoundly unfair to plan beneficiaries. Where they exist, defined-benefit pension benefits form a key term and condition of the employment contract, representing deferred earnings that exchange current compensation for a future pension promise. To later retroactively rewrite the terms of this agreement, and to replace the employer's obligation to adequately fund the plan with the requirement that accrued benefits and even pensions-in-pay be reduced in the event of funding shortfalls, is deeply unjust and runs counter to the widely-shared understanding of the obligations of contract. We question whether the Federal Government has the constitutional right to expropriate active and retired members' vested property rights in such a manner.

The consultation document explicitly contemplates DB plans with solvency funding shortfalls being given the option of a TB conversion. We are concerned about the prospect of a federally-regulated private-sector employer entering the distressed pension plan workout process or *Companies' Creditors Arrangement Act* (CCAA) proceedings, with the result being a target-benefit plan that employees and retirees are herded into under duress. Inviting private-sector employers and Crown corporations to pursue conversions to target-benefit plans—either in the course of a distressed pension plan workout process or CCAA proceedings—is a dangerous step that could invite cascading efforts to dispense with accrued pension benefit liabilities.

Compounding balance-sheet pressures arising from the adoption of international accounting standards for employee benefits, which recognize actuarial gains and losses immediately, investors will pressure employers to eliminate pension liabilities even where plan sponsors themselves don't pursue the option. Even with employer obligations to fully fund going-concern liabilities at conversion, the prospect of abandoning these liabilities would be too attractive for employers to

resist. Allowing employers to relieve themselves of accrued benefit obligations is a dangerous and irresponsible step, which in an environment of intense competition and investor pressure for low risk and high returns, will compel other employers and sponsors to similarly rid themselves of accrued liabilities.

We also believe that despite protestations to the contrary, either now or in the future the Federal Government would be prepared to expand access to DB-TB conversions into the public service, just as provincial governments have done. In effect, the Federal Government is signalling to private-sector DB plan sponsors, as well as public sector employers and other levels of government, that the need for continued adequate funding of DB pension commitments is now in question. For these reasons, the CLC recommends that the government withdraw its proposals for a federal framework for target-benefit plans.

Communication of Risk

The consultation document states that plan goals and risks to members must be clearly stated up front, but this is not the experience of other similar DB-TB plan conversions. Rather, in other instances, the risks entailed in converting from a DB plan to a TB arrangement were *not* clearly communicated, either because plan members were misled into thinking that their benefits were "97.5% guaranteed," or because the general promotion of 'shared risk' plans implied as much.[1] The federal consultation paper itself is not immune from this shading, writing that categorizing benefits as base benefits in the TB model makes them "subject to increased protection." In fact, conversion to TB arrangements, in which accrued and prospective benefits can be reduced, represents decreased protection.

The consultation paper uses the term "risk sharing," but these plans are more aptly characterized as "risk shifting" or "risk transferring," significantly reducing risks to the employer and passing them on to

[1] "Blaine Higgs Faces Pension Reform Backlash in Fredericton," CBC News, 18 April 2013.

active and retired plan members. The consultation document concedes as much where it writes that "under a TBP, the risk is shifted towards the plan members and beneficiaries."

When it comes to the specific probability that base benefits won't be reduced, we note that the consultation document employs the threshold of 90% probability, rather than the 97.5% used in the New Brunswick model. Claims concerning the near certainty of any of these numbers must be viewed with skepticism—they are simply statistical modelling—but it is noteworthy that the bar is falling.

Similarly, the consultation paper misrepresents matters when it writes that DB plans offer "limited flexibility" for adjustments to cope with funding shortfalls, and that "plan sponsors are solely responsible for funding deficits." This is simply inconsistent with the experience of DB plans over the previous six years, when DB plans made significant adjustments to plan provisions in response to shortfalls, and plan members shared the cost of addressing deficits in the plan. Via collective bargaining, unionized DB plan members have negotiated contribution increases, special temporary funding arrangements borne by sponsor and beneficiaries, and temporary (where possible) benefit reductions. But they have endeavoured to preserve the essential defined-benefit design of the pension plan, knowing the advantages of DB plans and the characteristically cyclical nature of the funded status of DB plans. These pension arrangements have proved in practice to be capable of flexible, creative and equitable adjustment under pressure. The last several years in the wake of the financial crisis have seen considerable pressure on DB plans. In a vast number of cases, the parties through collective bargaining have reached compromises for sharing the cost of adjustment.

Restrictions on Trustees and Bargaining Agents

We welcome the recognition made at one point in the consultation paper —although at odds with the opposite view expressed elsewhere in the

document—of the advantages of plan administrators retaining flexibility and plan discretion with respect to identifying certain benefits as fully guaranteed. However, other aspects of the consultation document are in tension with this point, and co-exist uneasily alongside emphasis elsewhere on legislative prescription. These tensions and contradictions exist with respect to fiduciary duty. On the one hand, the consultation paper contemplates a "board of trustees with fiduciary duty to the plan," but in the next breath, holds that "the administrative body of the TBP should have the capacity to make decisions in the interest of the employer, plan members and retirees." The paper specifies that trustees would not have the power to amend plan documents, yet contemplates elsewhere they could retain these powers.

Negotiated contribution levels are a crucial part of collective bargaining over pensions, and DB plans must flexibly revisit contribution rates in the event of plan underfunding. During the last several years, private-sector and public-sector plans have revisited this question, often adjusting contribution levels as needed. Limiting this ability is a perverse restriction on the flexibility of plans. Therefore the CLC disagrees with the proposal that "a cap on the chosen variability level for both employer and employee must be provided." This requirement would unduly restrict the decision-making of future plan members and trustees. Potential contribution rate increases must form part of a pension plan's funding deficit recovery mechanism, precisely because the future is unknown, and because benefit reductions ought to be avoided. If contribution increases are removed from the equation by fiat, it is equivalent to sacrificing the capacity to respond flexibly to unpredictable future challenges.

Pension Coverage and Sustainability

According to the consultation paper, the government's initiative purports "to help promote pension plan sustainability, and to continue to improve overall pension coverage and adequacy for Canadians." In fact, pension coverage rates continue to decline rather than improve, largely because

private-sector employers are unwilling or unable to offer workplace pension plans.

If the Federal Government wishes to pursue the objective of expanding pension coverage, there are a variety of mechanisms it could—and indeed would—need to pursue. Defined-benefit pension plans remain the single best mechanism for providing secure and predictable retirement incomes for workers. In areas in which DB plans do not exist, and are unlikely to exist, such as industries characterized by small workplaces and a high rate of employer entry and exit, where single-employer plans are not feasible and there is no realistic ability of the employer to make up funding shortfalls, multi-employer pension plans (MEPPs) could be made more readily available to employers and employees without workplace plans. If the Federal Government is serious about expanding and improving access for non-unionized employees, it could collaborate with the provinces and work with unions and employer associations in suitable sectors to encourage the adoption of multi-employer pension plans in areas with low levels of pension coverage.

Multi-employer pension plans have often worked well federally, and in other jurisdictions, for decades. Grounded in union representation and collective bargaining, multi-employer target-benefit plans have been able to offer pensions to workers in smaller, transient workplaces. Superior to group RRSPs and defined-contribution plans, MEPPs function like a DB plan, providing a known pension benefit calculated according to a benefit formula, set out in the plan document. They can offer early retirement provisions and survivor benefits, and pay out a commuted value on individual plan termination and death. MEPPs pool longevity risk and are invested for the long-term like DB plans, with a single pool of investment capital delivering a higher benefit than would a capital accumulation plan, for an equivalent cost. They engage actuarial oversight, and are governed by an independent board of trustees with a fiduciary duty to plan members.

Although contribution levels are ultimately subject to collective bargaining, and not fixed in law, MEPP contribution levels typically do

not adjust in response to plan underfunding, and benefits can be adjusted (increased or reduced) as required. But the central role of unions ensures that stable benefits are the top priority, that benefit reductions remain the last resort only after other adjustment options are explored, and that plan members' interests are clearly articulated and respected in the process. These advantages would be lost if the flexibility afforded by collective bargaining were constrained by legislation and regulatory prescriptions. In situations where there is no union present or centrally involved, concerns also arise over the ability of workers to avoid benefit reductions if retaliation is threatened for withholding consensus around plan changes. Non-union workers may also find themselves at a disadvantage due to a lack of resources and expertise to interpret and analyze complex proposals entailing benefit reductions. We therefore question whether target-benefit plans are practicable in a non-union environment.

The proposed framework raises the prospect of defined-contribution (DC) plan conversions to TB plans, although even if employers converted from DC plans to single-employer TB plans, no improvement in pension coverage would result. But we find it difficult to imagine in the current environment that employers would be prepared to voluntarily convert DC arrangements into target-benefit schemes. In principle, a target benefit plan offers important advantages over defined-contribution plans, for the reasons enumerated above. However, it is unlikely that an employer sponsoring a DC plan would opt to convert to a TB plan, absent union pressure to do so. From the employer's vantage point, target plans with fixed employer contribution rates would function in a manner similar to DC plans. Yet insofar as any variability in contribution levels is allowed, target plans would involve less certainty and potentially more cost for employers, and certainly more administrative headache relative to a DC plan administered by an insurance company. If anything, employers have a measurable incentive to convert DC arrangements not to TB plans, but to Pooled Registered Pension Plans (PRPPs), which almost entirely unburden employers of the administrative work left to insurance companies and other PRPP providers.

We are sceptical that the government's proposed framework is intended to address the low and declining level of pension coverage in Canada. It seems counterproductive to us that the Federal Government wishes to expand pension coverage while making it possible for existing DB plan sponsors to divest themselves of past pension promises, and withdraw altogether from plan governance. Going further, removing legal protections for workers' deferred earnings and allowing the reduction of benefits earned through past service will further deter workers from saving for retirement collectively through pension plans. If market fluctuations may reduce my accrued benefits, workers may ask, why bother participating in the pension plan in the future? Against this backdrop, the Federal Government refuses to even discuss the improvement of Canada's inadequate public pension plans to address the nearly 12 million Canadians in the labour force with no workplace pension plan.

In the CLC's view, this initiative is chiefly, if not exclusively, an effort to allay employers' concerns regarding the cost of DB plans. We believe it is unsatisfactory and inadequate to frame the question of sustainability entirely in terms of cost, more specifically the cost to the employer, and in isolation from the adequacy and security of members' pensions. Sustainability cannot be reduced purely to a question of employer cost, with no serious consideration of the objectives of pension adequacy, security, and equity. A pension plan can, of course, deliver an extremely low benefit at relatively high cost to plan members, with a very high level of predictability and very little risk to the employer. But this is unlikely to be a plan that fulfills the goal of retirement income adequacy and retains the support of plan members.

Summary

The CLC believes that allowing plan sponsors to convert DB plans to target-benefit arrangements is a dangerous step that will potentially destabilize existing pension funding agreements and generate uncertainty with respect to the future of DB plan funding not only

federally, but nationally. It risks undermining the resiliency of DB plans that are now returning to health six years following a severe global financial crisis and economic recession. DB plans are too valuable as a vehicle for pooling risk and providing predictable, secure retirement income to undermine in such a manner.

The CLC disagrees with any policy initiative that contains the notion that employees must ultimately fend for themselves in retirement, and that employers share no obligation for the welfare of workers after leaving their employ. Workers have virtually no power to shape the outcomes of financial markets and have far fewer resources than employers to manage the risks and consequences of market volatility. Their retirement security must not be left to the investment performance of the pension fund simply in a bid to insulate employers from the current actual and potential future costs of pension provision.

With this proposed framework, the Federal Government is narrowly addressing employers' concerns to limit cost and risk, while ignoring the significant challenges to retirement security that Canadian society faces, with its various dimensions of growing financial insecurity and inadequate incomes. We are frustrated with the perversity of an initiative that not only ignores this pressing challenge, but would effectively aggravate it. Simply relieving employers' cost pressures at the expense of plan beneficiaries represents a false solution to a much larger, urgent problem.

The CLC urges the Federal Government to return to its 2010 commitment to implement improvements to the Canada Pension Plan. A phased-in, fully funded doubling of future CPP retirement benefits remains the most efficient and cost effective means of addressing the problem of inadequate retirement savings in Canada. Unmatched by any private sector retirement savings scheme, the CPP delivers a secure, dependable retirement benefit, protected against inflation and payable until death, at a very low cost. The CPP is funded through earnings based on contributions so that future beneficiaries are not dependent on

future tax revenue. Virtually all working Canadians are already members of and contributors to the CPP.

At a minimum, a national debate on the security, adequacy and sustainability of Canada's retirement income system is long overdue. In place of its target-benefit initiative, the CLC calls on the government to begin an integrated, comprehensive dialogue on current and future retirement security needs in Canada, and the efficiency and effectiveness of our retirement income system in meeting those needs.

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