Public Service Alliance of Canada
Alliance de la Fonction publique du Canada

SUBMISSION BY THE PUBLIC SERVICE ALLIANCE OF CANADA

TO THE HONOURABLE BILL MORNEAU, MINISTER OF FINANCE

REGARDING BILL C-27, *AN ACT TO AMEND THE PENSION BENEFITS STANDARDS ACT, 1985*

MAY 2017

POSITION OF THE PUBLIC SERVICE ALLIANCE OF CANADA

I. THE PUBLIC SERVICE ALLIANCE OF CANADA (THE "PSAC")

The PSAC represents 180,000 members who work in 318 bargaining units, the vast majority of which are part of the federal sector. PSAC members work directly for the Government of Canada, and also work for federal Crown Corporations and other employers that are subject to the federal *Pension Benefits Standards Act*.

Just over 10,500 of our members could be affected immediately by Bill C-27, *An Act to amend the Pension Benefits Standards Act, 1985*. They include members at Canada Post and Purolator, NAV CANADA, airport and port authorities, employees of First Nations, support services on military bases, the Bank of Canada, the Dominion Diamond Corporation, and various bargaining units in the Yukon and NWT.

Also of particular concern is that Bill C-27 could be used as an example and "template" to convert or erode the public service pension plan benefits that provide stable retirement income for federal government workers.

II. INTRODUCTION

Bill C-27 provides only one option for pension reform. While pension reform is welcome, and the PSAC has been calling on your Ministry to provide meaningful reform for several years, a single-option reform is simply not appropriate, particularly in the public and broader public sectors. The challenges facing public and broader public sector pension plans — including funding challenges — can be met and addressed in a variety of ways, including targeted solvency relief, joint governance platforms, and others. Each of these should be part of a balanced package of reforms, and not simply a tabling of legislation. This bill runs with similar concepts contained in a discussion paper issued by the previous government. After receiving considerable criticism, it is noteworthy that the previous government decided not to introduce legislation on target benefit plans.

The essential options created by Bill C-27 give employers an opportunity to replace secure and predictable "defined benefit" retirement plans with "target benefit" plans. From the members' perspective, the defining feature of a target benefit is that it can be cut, even retroactively. Members' retirement income security would fall, and if benefits are cut so would their quality of life.

Replacing secure and predictable "defined benefit" pensions with pensions that are "target" and may be reduced at any time — including in retirement — is a mistake.

Canadians require decent pensions upon which they can rely — pensions that are secure and predictable, and that allow them to plan their retirements accordingly. Not knowing how much a pension will be next week or next year undermines the retiree's security in retirement, compromises the retiree's quality of life and weakens the retiree's ability to participate in their community and support their local economy.

Predictable and secure pensions are not the problem that requires addressing today. The real pension problem is that two thirds of Canadians have no workplace pension at all. They rely on the Canada Pension Plan and a hodgepodge of high-fee, finance industry-friendly private retirement savings plans that are inadequate to the task of real retirement savings.

Target benefit plans can be a useful vehicle for workers in sectors where employers are sometimes unstable. However, in the public sector, where employers do not come and go, target benefit plans are not the appropriate solution and do not provide the platform Canadian employees need for their retirements; target plans will become part of a growing retirement income problem in Canada, and will form no part of its solution.

III. THE PURPOSES OF PENSION PLANS

Pension legislation often invites us to "get into the weeds" and consider narrow albeit important issues.

But the changes proposed by Bill C-27 are profound. It reframes the nature of the pension promise that employers make to their employees and retirees, and this will have profound impacts on those employees and their families.

The basic purpose of a pension plan is to provide decent retirement incomes that are secure and predictable. The promise of a pension is essential to attracting and retaining employees in an economy that is strong and competitive, and in the public sector, when private sector wages continue to outpace public sector wages.

Decent, secure and predictable pensions give their recipients "pension confidence". Pension confidence means that people, while they work, can spend their earnings, knowing that their retirement days are secure. As important, pension confidence also means that retirees can spend each pension check, knowing with confidence that their income stream is not in doubt. Pension confidence underpins the economies of many small communities with significant pensioner populations and the small businesses that serve them.[1]

The real problem in the pension sector is the number of people who do not participate in decent pension plans. In some cases, employees without pension plans earn incomes that allow them to save for retirement, but the savings mechanisms available to them from financial institutions are typically expensive and inefficient in comparison to large scale pension plans. In other cases, a decent pension plan is the crucial bridge that could allow modest income earners to save enough for a decent retirement. In all cases, the lack of pension coverage across Canada hurts the country, and hurts its regions.

Looking forward, for example, Professor Michael Wolfson projects that half of Canada's middle income earners will experience a significant decline in their standard of living

[1] See, for example, the positive economic effects of defined benefit plans set out in Boston Consulting Group's report, *Defined Benefit Plans: Strengthening the Canadian Economy*, October 22, 2013, available online at: www.otpp.com/news/article/-/article/701993.

standards after retirement. In his paper, "Projecting the Adequacy of Canadians' Retirement Incomes[2], published by the Institute for Research on Public Policy in April 2011, Professor Wolfson concluded that "…roughly half of Canadians born before 1970 who had mid-level earnings in their pre-retirement years will face declines of at least 25 percent in their living standards (i.e., consumption possibilities) post-retirement." These findings have been confirmed in other studies of income replacement prospects for Canadians[i]. This failure is largely owing to the inadequacy of pension coverage in Canada. This is the real problem that presses for a solution.

IV. PROBLEM FEATURES OF BILL C-27

Bill C-27 leaves several key issues for any target benefit plan unaddressed, and as a result is unclear and potentially misleading. More broadly, Bill C-27 will not create new pension plans, and creates the possibility that past pension promises will be broken.

Statutory scheme unclear

Target benefit plans are not new in Canada — they have existed in the multi-employer pension plan space for some time. Industries that have adopted the multi-employer model include construction and transportation — typically industries in which there is a higher risk of employer insolvency or exit. Experience with multi-employer pension plans suggests that some of the key governance features — reflected in legislation and regulations of multi-employer plans — are essential to their successful management. These features are entirely absent from Bill C-27.

The most important feature is the relationship to collective bargaining. Multi-employer target benefit plans require at a minimum there be some form of joint governance of the plan, so that the risks that the members are exposed to can be managed by their representatives. There is no mention in Bill C-27 of the role of collective bargaining agents or the requirement for joint governance of TB plans, and only the requirement that a single member be appointed to the administrative body of the plan. This is a significant departure from the best governance practices for target benefit plans. In the public and broader public sector joint governance has often been achieved through the jointly-sponsored, jointly-governed plans. We will discuss this model in more detail under Part V.

A second and related major "question mark" in Bill C-27 are the unanswered questions about the requirements for a "funding policy" and a "governance policy". The funding policy is required to state the benefit formula and subsequent changes to it, as well as contribution rate changes and deficit amortization and surplus use policies. Each of these may be subject to regulation. It may be that the regulations themselves will be overly prescriptive with these key features — or not. It is impossible to evaluate the balance struck by this legislative proposal without them. For example, will funding policies prohibit the application of surplus to employer contributions? In a target benefit plan, in which members and retirees bear all the relevant risks, they should also own all the relevant rewards, but this is not stated in Bill C-27, or made a condition of a funding policy.

[2] See also LaRochelle-Coté, S., J. Myles, and G. Picot, 2008. Income Security and Stability during Retirement in Canada. Analytical Studies Branch Research Paper Series no. 306, Ottawa: Statistics Canada.

To summarize, Bill C-27 does not contain the best practices learned from other target benefit plans — notably multi-employer plans. It leaves open or perhaps permits a significant mismatch between risk and reward in these plans. It fails to require, or specify, limits on surplus use, for example. It also fails to say how the funding or governance policies will be directed to mitigate member and retiree risks, and not favour employer interests.

New pension plans will not be created

Bill C-27 does not address the fundamental problem of pension coverage. Employers will not establish new target benefit plans where no plan currently exists, and they will not convert existing defined contribution plans to target plans. There has been no cry from employers for target plans to improve coverage. Rather, Bill C-27 will allow employers will use the target benefit plan provisions to convert good defined benefit plans that provide decent, secure and predictable benefits, into the much less secure form of target benefits. No such conversions should be permitted; good pension plans should be preserved and expanded, not downgraded.

Earned pension promises will be broken

Perhaps most outrageous to see from a government with responsibility to protect peoples' pensions, is a bill that proposes that benefits already earned and paid for by a member in a defined benefit plan—including by retirees—may be cut. Accrued defined benefits may be converted to target benefits, and those target benefits may be reduced. The very benefits towards which members have worked and made contributions, and that have been guaranteed by their employers, may be converted to target benefits guaranteed by nobody.

Pensions provide life income benefits that people depend upon when they can no longer work. But these types of financial products do not entail the level of uncertainty that the proposed "target benefit plan" would carry.

No one would deposit money in a bank account if their account balance could be reduced at any time and in any amount. No one would agree to pay premiums for a life or other insurance policy if the amount of coverage could be reduced at any time or in any amount. And it would be of little help for the bank or insurance company to say, based on their models, that there is a 90% chance the bank account or insurance policy would retain its value. The models upon which such projections are based are not good enough to provide any real level of comfort at all — after all, much more sophisticated financial models failed in the 2008-09 financial crisis. People want and deserve certainty in their financial products, and nowhere more so than in their pension plans. It is the government's role to regulate financial products, including pensions, so that financial promises are kept.

In the PSAC's view, promises made should and must be kept. The most basic purpose of pension regulation is to ensure that people can rely on their employers' pension promises, and that those promises are kept. Instead, in Bill C-27, the federal government proposes that pension promises made by federal sector employers to their employees may be broken.

Voluntary consent provisions are a sham

Bill C-27 provides that defined benefit plans may convert to target benefit plans with the “consent” of the members and retirees. The PSAC knows this will not be a meaningful consent process in many cases. Bill C-27 would permit employers to pressure their workers and retirees into “surrendering” their pension rights. In the past employees have demonstrated their willingness to enter arrangements or provide funding relief for pension plans — which implicitly takes on certain risks — but have not compromised accrued benefits, which remain an important feature of their pension plans. Bill C-27 now makes it likely that employers will pressure employees to do both.

The government is promoting the notion that under Bill C-27 moving from a defined benefit plan to a target benefit pension plan is completely voluntary and that employees and retirees can decide whether or not they want to change from one plan to the other. This benevolent scenario is far removed from reality.

Employers stand to gain much from converting to target benefit plans. As a result, they are motivated to use every short-term incentive and every pressure tactic they have to compel and persuade employees and retirees to surrender their protected defined benefits for unprotected target benefits. Employers can threaten job losses and cost-cutting or offer short-term incentives such as lump sum cash payments or improvements in paid leaves or welfare benefits that are appealing at the time of offer.

The protection of guaranteed vested pension benefits has been the core objective of pension regulation in Canada. Employers have made defined benefit commitments with their eyes open. Employees have worked and contributed to earn those benefits. Federal pension legislation has protected those benefits and prohibited their reduction. The federal pension regulator has been mandated to ensure that vested pension benefits, promised and earned, are delivered. To permit those vested benefits to be undone, even on the basis of a so-called consent process, is unconscionable.

The New Brunswick example is not a model

New Brunswick illustrates the perils of the target benefit regime. The provincial government introduced the “shared risk plan” — a form of target benefit plan, claiming buy-in from trade unions and retirees in the process.

In fact, as more details emerged about these plans, the true risk and nature of them became apparent, and litigation over these plans has ensued. Furthermore, these risks and nature were obscured, even by the name of these plans, as “shared risk”. As the Government of New Brunswick admitted to the province’s Auditor General, there is nothing “shared” about the risks under the New Brunswick target plan model – the risks (investment, mortality and ultimately, of benefit reductions) are overwhelmingly on the members and retirees in those plans, with employers bearing no risk in regard to them at all.

The New Brunswick example also includes plainly misleading assertions about the security of retirement income benefits. Some of these assertions are based on future modelling, which has the appearance — but not the reality — of scientific accuracy, expressed through complicated and overly-deterministic regulations. The modelling behind those regulations has not yet been successfully confirmed by independent third parties, and yet an entire public pension system was converted on the basis of it. As New Brunswick's promises fail, confidence in its system will falter and stakeholders will become justifiably angry.

As we noted above — the lack of clarity and the false confidence placed in projection models (which are very sensitive to small changes in assumptions and not well understood) creates an environment for uncertainty and misleading information about pension plans, an already complex area for members and employers alike.

V. AN ALTERNATIVE TO TARGET BENEFIT PENSION PLANS

The most successful pension model in Canada — jointly sponsored defined benefit plans

Within the sphere of workplace pension plans, Canada's experience has led the world — not in the direction of 'target' plans, but rather towards 'jointly sponsored plans' that provide secure and predictable defined benefits.

Canada has been a world leader in pension innovation. Pension boards, including the Ontario Teachers' Pension Plan Board ("OTPPB") and the Healthcare of Ontario Pension Plan ("HOOPP") are often cited examples of leadership in pension management and investment. The OTPP and HOOPP, along with the British Columbia Municipal Employees' Pension Plan, the British Columbia Public Service Pension Plan, the British Columbia Teachers' Pension Plan, the British Columbia College Pension Plan, the Ontario Municipal Employees' Retirement System, the Colleges of Applied Arts and Technologies Pension Plan and many others, are successful examples of a pension governance model pioneered in Canada, and now known as the "jointly sponsored defined benefit plan" (the "JSDBP") model.

PSAC members already participate in many provincially regulated JSDBPs. PSAC members belong to a number of JSDBPs, including OMERS (covering PSAC members at the Windsor, Timmins and North Bay Airports, the Port of Prescott, and Town of Moosonee), the British Columbia Municipal Plan (covering PSAC members at Victoria Airport and B.C. First Nations Health Authority) and HOOPP (covering PSAC members at the Weeneebayko Area Health Authority).

Most recently, Keith Ambachtsheer and Jim Leech have made the case for this model of pension delivery.[3]

JSDBPs provide secure and predictable benefits

It is critical to spotlight that the JSDBP model does not change the nature of the pension promise, nor did it undermine confidence in the pension system. Under a JSDBP model,

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[3] Memo to the Hon. Bill Morneau, from Keith Ambachtsheer and Jim Leech, March 14, 2017, Re: Time for Innovation in Federal Government-Sponsored Workplace Pension Plans, CD Howe Institute, available online: www.cdhowe.org/intelligence-memos/ambachtsheer-leech-time-innovation-federal-government-sponsored-workplace-pension.

pensions are accrued with every year of service, and once accrued they cannot be reduced except in the extraordinary event of plan wind-up. JSDBPs provide decent, secure and predictable pensions and maintain pension confidence among their members — a confidence that is generally enhanced by the participation of their representatives in pension governance. JSDBPs have strengthened the pension system in Canada and continue to attract widespread support and approval from all over the world.

It is also important to add that, while JSDBPs have been very successful, and their absence from the PBSA needs to be corrected, JSDBPs are not the appropriate pension model in all cases. Where adequate, secure and predictable benefits can be delivered through existing models, those models may well be preferable to JSDBPs.

VI. THE *PENSION BENEFIT STANDARDS ACT* NEEDS BROADER REFORMS

The *Pension Benefits Standard Act* (PBSA) urgently needs reforms, though not “target benefit plan” reforms.

The PBSA needs reform of its solvency funding rules

All workplace pension plans should be ‘funded’ — monies should be set aside each year to pay for the pensions earned in that year, and, if there are any shortfalls in the pension plan (due, for example, to investment losses) this should be made up through additional contributions.

In Canada, we use two different sets of funding rules.

'Going concern' funding rules recognize that pension plans are long-term arrangements, and that, while investment returns and interest rates will fluctuate, there are reasonable, historically based returns and rates that can be used as a basis for funding a pension plan. Going concern funding rules are based on such long-term returns and rates, although they are also sensitive to a changing long term environment. For plans that will endure for a long time, and can absorb the volatility of financial markets, going concern funding rules are sensible ways to fund a pension plan.

'Solvency' funding rules are more problematic. They are based on the assumption that the pension plan will be terminated and wound up immediately. In this case, annuities must be purchased from insurance companies for some plan members, and actuarially determined lump sums must be paid to other members. Annuity prices are very expensive. Even though most plans won’t be wound up and forced to buy annuities and make these lump sum payments, the PBSA requires that all pension plans be funded on the assumption that they will terminate and wind-up, and that annuities will be purchased and lump payments will be made. This is a wholly unrealistic assumption for most plans.

The most sensible solution to the problem of termination and wind-up, when we know that some plans will terminate and wind-up but most will not, is not to compel every single pension plan to set aside enough money to cover a wind-up. This is inefficient and costly; most plans won’t wind up and so won’t need to be funded as though they will be wound up. Rather, the pension sector requires a government-sponsored pension insurer that will cover those plans that do wind up with a deficiency. The amount of premiums can be determined to cover expected wind-up deficits system-wide, and will cost much less than the current prohibitively expensive PBSA requirement that all plans be funded on the basis that each one of them will be terminated and wound-up.

Several jurisdictions in Canada — in fact, most — have modified their solvency funding regimes to a greater or lesser extent. It is untenable that the federal jurisdiction does not engage in this exercise as well.

In Quebec, for example, the solvency funding rule has been eliminated for all pension plans, and the going concern regime has been enhanced. We cannot summarize all the features here, but the Government of Quebec has taken bold steps to enhance going concern funding, limit the ability to apply surplus to contributions, and to provide an alternative to the wind-up procedures that may be too expensive. The rationales for these measures are the same as those articulated by the federal government for Bill C-27: to stabilize costs of pension plans and provide meaningful benefit security.

In Ontario, the provincial government is actively studying reforms to the solvency funding regime, including more “relaxed” solvency funding requirements or eliminating it and requiring enhanced going concern funding, in connection with enhancements to the Pension Benefits Guarantee Fund as a means of enhancing benefit security, as well as exploring alternatives to the wind-up procedures that are too costly.

Other provinces have also introduced “targeted solvency relief”, particularly to public and broader public sector employers, who are at lower risk of insolvency in the first place. Saskatchewan has eliminated solvency funding for major broader public sector employers, and introduced a form of enhanced going concern funding. British Columbia and Alberta have similar initiatives.

In summary, in addition to adding a new benefit plan type, most other jurisdictions in Canada have also explored options to address level and volatility of pension plan costs through forms of solvency relief and new governance models. As we briefly mention above, one of these models — jointly sponsored and jointly governed — was originally developed in the broader public sector, and is the most successful model of pension governance and performance in Canada. The federal government should be actively developing this model, particularly for the federal public and broader public sectors.

The PBSA needs a JSDBP regulatory framework

The PBSA does not currently accommodate JSDBPs, even though JSDBPs are the most successful form of pension plans in Canada. It should be reformed to provide for JSDBPs that deliver secure and predictable pensions — not to permit employers to replace secure and predictable pensions with “target” benefits.

Sensible reforms would include the introduction of a JSDBP regulatory framework into the PBSA. Remarkably, the PBSA doesn’t even contain a definition of a JSDBP, much less a sensible regulatory framework for them. Existing pension legislation in Ontario, in British Columbia, Alberta and Nova Scotia all create a regulatory framework for jointly sponsored pension plans. The PSAC would be pleased to participate in a consultation process directed to updating the PBSA and creating the possibility of JSDBPs in the federal jurisdiction.

VII. SUMMARY AND CONCLUSIONS

- The key objective of any pension system is to provide decent, secure and predictable pensions. Any conversion of defined benefit to target benefit plans will not achieve this objective. To the contrary, target plans will shift financial risk from employers to employees and pensioners, increase pension uncertainty and reduce pension benefits.

- Reforms to the PBSA are required, but reforms are not needed to convert good pensions into pensions that provide unreliable benefits.

- Reforms are necessary to allow for jointly sponsored defined benefit plans in the federal jurisdiction. The federal PBSA is a laggard in this respect—well behind Ontario, British Columbia, Alberta and Nova Scotia.

- Reforms are also necessary to relieve pension plans of onerous solvency funding obligations. A public pension insurance arrangement is needed to protect benefit security in those plans that do fail, without burdening the system as a whole with expensive solvency funding requirements.

- Bill C-27 presents real risks to employees and retirees:

    - Employers will convert good defined benefit plans into target plans.

    - Existing benefits earned and paid for by members, and backed by their employer’s promise to pay any deficiency, will be stripped of that employer promise, through a so-called “voluntary consent” process that provides ample opportunity for employers to apply undue pressure on employees and retirees. This will mean that employers will be allowed to break the pension promises they have made to their employees and pensioners, who will suffer pension uncertainty and benefit reductions as a result.

    - Target plans will be complex and expensive to administer, and will offer benefit security based on models of a future that is 20 years away; no models are capable of predicting the future to a 90% level of certainty, and any promises based on such models are simply misleading and corrosive of Canada’s pension system.