CANADIAN FEDERATION OF PENSIONERS
ADVOCATING FOR PENSIONERS

FÉDÉRATION CANADIENNE DES RETRAITÉS
POUR LES RETRAITÉS

Submission on the Recommendations of the Expert Committee Report on the Future of Québec's Retirement System

Presented by the Canadian Federation of Pensioners

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This submission regarding the recommendations of the Expert Committee on the Future of the Quebec Retirement System ("The Report") is presented by the Canadian Federation of Pensioners (CFP).

CFP is an organization comprised of DB pensioner associations. CFP is a growing organization, and currently consists of 15 associations, some of which represent pension plans under federal regulations, and others that are provincially regulated, including Québec. The member organizations of CFP represent the interests of 250,000 Canadians. CFP has a keen interest in the evolution of legislation and regulations pertaining to DB pension plans in Canada, and advocates on behalf of all retirees with the objective of promoting pensioner security. The Appendix to this submission lists the member associations of CFP.

We are pleased that the Quebec government has afforded us an opportunity to comment on the Report. We believe the Report makes a valuable contribution in depicting the inadequate funding that persists in DB pension plans generally, and in describing the pressures facing these plans. Though outside our specific area of expertise, we believe that the longevity pension recommended by the Report would be a positive development for Quebecers generally. However, on those areas of the Report that pertain to DB private pension plans, our enthusiasm for the Report is greatly diminished.

As will be clear from the comments that follow, the CFP finds the recommendations in this area to be generally disappointing. Where pensioners are looking to government to strengthen the security of the pensions that have been promised to them, the recommendations undermine that security. Some recommendations are an open invitation to reduce the benefits that retirees have earned through their life of employment. Those recommendations that would affect the funding levels of pension plans would have the effect of hiding the degree to which plans are under funded, rather than solving the very real problem of underfunding.

Objectives

The Report offers two objectives for the retirement system; namely, (i) that it ensures sufficient and realistic retirement income, and (ii) that it be designed and funded so that it will endure.

The retirement income system has many components, one of which is the defined benefit pension plan benefits for those individuals who are members of DB plans. Other components include private savings, OAS, QPP/CPP and GIS. Though CFP supports the objective of sufficient and realistic retirement income and the endurance of the system generally, those systemic objectives are of no comfort to the individual if they come at the cost of that individual's pension security.

Retirees who are members of DB plans have completed their lifetimes of employment. They have done so on the understanding that in their retirement years their income would be made up, in substantial part, by the pensions that had been promised to them throughout their working years. Their pensions are partial compensation for the work that they have already rendered to their employer, the other part being the wages/salary they received during their working life. These individuals have no recourse to recoup any loss of pension through other means. They are not able to re-enter the labour force; they are not able to find some additional source of income that has eluded them up until the time of pension loss. Retirees are uniquely susceptible to any reduction in their pension income. In comparison, a younger individual who suffers a job loss faces difficulties, but at least he/she has the opportunity to seek income elsewhere.

Retirees are looking to government to put in place pension rules that will give assurance that the pensions that had been promised to them will be delivered. In other words, they look to government to do what it can to secure the pension amounts that have already been promised to them. These promises have been the cornerstone of the financial planning for the later years of their lives. Further, because they have accrued these pension benefits, access to other avenues of retirement saving has been restricted. Potential RRSP contributions have been limited by the existence of their promised pensions. It is all the more important for government to do what it can to support the promises made to them, when it is realized that the government has curtailed their savings opportunities because of these promises.

The objectives of the retirement system must encompass the security and sustainability of the system generally, but must also encompass the security of the individual promises that have already been made. It is upon these promises that many individuals have already planned their financial futures. The first two objectives are included in the report, the third is not. We strongly recommend that the Government's pension policy be guided by an additional objective, namely, promoting the security of the pension promises that have already been made to members of DB pension plans.

Values

The Report has selected three values upon which to base its recommendations: (i) intergenerational equity, (ii) transparency, and (iii) accountability.

On the question of intergenerational equity, it has been said that generous pension benefits enjoyed by older pensioners have left plans chronically underfunded. Further, it is said that younger plan members, through their contributions to the pension plan, are left to pay for these benefits. This, it is argued, is a form of intergenerational inequity that can and should be cured by cutting back the benefits of the older pensioners. The reasoning is faulty, and the conclusions are wrong. In fact, it is nothing more than attempting to solve one inequity by replacing it with another. That is, the intergenerational funding inequity would be remedied, under this reasoning, by unfairly breaking the pension promise that has been made to the older pensioners. There is a solution to the intergenerational inequity, and it lies in proper plan funding practices and not in retroactively rewriting the compensation package for work that has already been done.

It should first be noted that the argument cannot be made for non-contributory plans. For these plans, it is the sponsor alone who is required to remedy the plan's funding. By definition, these plan members do not make explicit contributions to the plan.

Whether a compensation package is "overly generous" is a subjective matter, and not all observers will be of the same opinion. The fact is, though, the pension benefits that form part of the compensation package were agreed to by all parties. Just as reasonable observers would not call for a retroactive reduction in salary received for work in past years, there should be no reduction in pension benefits for years that have been completed. For all the reasons discussed above, there should be no retroactive adjustment of benefits that have already accrued.

For all plans, one has to keep in mind that "underfunding" simply means that the plan's assets are not sufficient to cover its liabilities. Of course a plan's assets include member contributions for contributory plans, but for the most part reflect the investment performance of the plan. Accountability for plan performance lies with the plan sponsor and administrator. Liabilities necessarily reflect the benefits for all plan members, active and retired, and also move with market conditions such as the discount rate. As interest rates fall, for instance, liabilities rise without any change to the benefits package. The last several years have been characterized by persistently low discount rates which have, in turn, lead to increasing liabilities and a declining funding status of plans. Conversely, higher interest rates would lead to decreasing liabilities and improved funding status, again with no changes to benefits.

The eighties and nineties were typified by higher interest rates, and plan contributions were consequently lower. There were no claims of intergenerational inequity in that instance: older pensioners were not thought to have been disadvantaged because their contributions in earlier times were higher than those of the younger plan members. There were no calls that the older pensioners' benefits should be enriched because of this perceived “inequity”. It was correctly concluded that the older pensioners had accepted the pension promise that was struck, and it was to that bargain that they should be held.

The potential for intergenerational inequity should be addressed by establishing robust funding rules that are capable, together with sound plan management, of minimizing the instances of plan under funding, both in terms of degree and duration. It is for that reason that funding requirements must be set with regard to liabilities that contemplate plan windup as a possibility, and must be set with the objective of eliminating solvency deficits within a relatively short period of time. The longer that deficits persist, the greater the opportunity for intergenerational inequity. CFP strongly supports retention of the five year amortization period for solvency deficiencies.

Also, the unique vulnerability of retirees, among the three groups mentioned in the Report, should be taken into account. Unlike active employees and young workers entering the work place, retirees have already lived their years of employment. Unlike these other two groups, they have already given their lifetime of labour for the promised compensation.

Pension policy should recognize the very real difference between changing the compensation for work that has already been given and changing the compensation for work that has not yet been given. It is open to employers and employees to come to a different compensation arrangement for work in the future. In fact, that is commonplace in the work market. But once the work has been completed, the agreed compensation should not be subject to change. To be clear, reducing pension benefits that have already accrued is no different than an employer telling its employee that it has decided to retroactively reduce that employee’s salary for a year that has already ended.

We recommend to the Government that pension policy should adopt the value that benefits already accrued should not be changed, neither increased nor decreased.

We agree with the value of accountability. Accountability is best reflected in pension rules that hold the employer to the promises it has made. In particular, the pension rules should, as much as possible, ensure that the promised pensions will be delivered to the pension plan members. The recommendations in the Report fall well short of this value; in particular recommendations 4, 14, and 16 work against it.

We fully endorse the value of transparency. A hallmark of transparency is that the reality of a situation be properly reflected, so that action can be taken if required. Though espousing transparency as a value, the recommendations do not reflect it consistently. As is discussed below regarding Recommendation no. 4, abandoning the solvency valuation for purposes of setting funding requirements will not address a very real risk to the pension promise.

Principles

The Report identifies four principles:

(i) The actual cost of funding retirement income must be respected

(ii) The diversification of retirement income sources must be maintained

(iii) The legal framework must provide leeway

(iv) Risk pooling must be promoted

CFP fully endorses principles (i), (ii), and (iv). Though (i) is a sound principle, and is espoused by the Report, Recommendation no. 4 appears to have paid no heed to it. This is discussed more fully below.

As for leeway in the legal framework, case by case solutions are preferable to one-size-fits-all solutions that too often penalise one to save others. The preferable approach is to establish pension funding rules, for instance, that could be expected to promote the security of the pension promises that have been made. If at the same time it is thought that those rules would be too onerous for a specific plan, or a specific group of plans, because of the particular pressures faced by them, then relief could be provided on a case by case basis, on the understanding that the general rules would be reapplied when circumstances permitted.

As for risk-pooling, it is our understanding that this principle underpins the proposal for the longevity pension. Risk-pooling, of course, is a feature of all DB pension plans.

Recommendations

The reader will find below CFP comments related to certain recommendations of the Report. These comments are limited to the recommendations that are associated directly or indirectly to the private sector defined benefit plans.

Recommendation no. 2

CFP support the recommendation to make mandatory a 100% capitalization of all enhancements provided to the Régime des rentes du Québec. This recommendation is in line with the truth of costs assumption stated before. It’s also what’s already done for the defined benefit plans of the private sector.

Recommendation no. 3

Recommendation no. 3 calls for identical financial rules for all plans subject to the oversight of the Régie des Rentes du Québec.

This recommendation may well work against achievement of the objectives espoused by the Committee, and the third objective proposed by CFP, namely, the protection of the pension promise. It also appears to be inconsistent with principle (iii), leeway in the legal framework.

It may well be that the particular circumstances faced by a plan, or group of plans, warrant an approach temporarily different than the rules of general application. The correct approach, which would accommodate pressures not uniformly experienced, would be to set rules that can be expected to be effective generally, and that would apply unless a case made for temporary relief is accepted. By "expected to be effective" is meant that the rules could be expected to minimize the risk to the pension promise. CFP proposes that a more sound approach is to adopt the practice that all pension plans under the Régie would be subject to the same financial rules, unless the case was successfully made by one or more pension plan administrators to the Régie that relief was warranted. In that instance, temporary relief could be granted.

We note that some provinces, and the federal government, have introduced temporary funding relief provisions in the past. Currently, federal pension rules allow for a process that would give funding relief to an employer who finds the funding requirement of the PBSA too constraining. These are examples of measures that have been taken to accommodate the particular pressures faced by some employers.

On the other hand, Recommendation no. 3 would appear to underpin the totally inadequate funding recommendations embodied in Recommendation no. 4. In this instance, the call for uniformity of approach would weaken the funding position of all plans registered in Quebec.

Recommendation no. 4

CFP have sought actuarial advice on the proposals contained in this recommendation. Based on this advice, it our understanding that a number of changes with respect to the funding of defined benefit pension plans are suggested. The primary suggestion is to use a proposed "Improved Funding" valuation as the only valuation used to determine minimum funding for all pension plans under the supervision of the Régie. This proposed valuation would replace both the current ongoing funding valuation and the solvency valuation for the purposes of determining the minimum contributions required to be paid into private sector pension plan funds. The proposed valuation would also be used by public sector pension plans. In this way, all pension plans under the supervision of the Régie would use the same minimum funding methodology.

The proposed Improved Funding valuation would use discount rates that are based on the discount rates used for accounting purposes during the member's expected post-retirement period. The expected investment return on the plan's fund assets would continue to form the basis for the discount rate during a member's assumed pre-retirement period. In today's environment that would cause the proposed funding valuation to generally produce higher liabilities and normal costs than under the current ongoing funding valuation. The proposed funding valuation would generally produce lower liabilities than under the current solvency valuation in today's environment.

The Report claims that this discount rate is closer to "financial reality". On the contrary, the accounting discount rate does not bring the plans' reported finances closer to its obligations should the plan have to be terminated.

It should be clear that the greatest risk facing a pensioner is that his/her plan is terminated at the same time it is underfunded; that is, when the assets are not sufficient to cover its wind-up liabilities. When this happens, typically the pensioner will suffer a decrease in pension payments, for the rest of his life and that of his beneficiary, to the same extent as the plan is underfunded. It is for that reason that plan funding targets have to be set in accordance with the solvency valuation as a minimum. If, instead, funding targets are set according to a valuation of liabilities that does not equal or exceed the plan's windup liabilities, then pension payments will necessarily be at greater risk of reduction should the plan be terminated. The reason is clear: funding targets were set to match liabilities that are less than the obligations of the terminated plan.

This is not just an academic concern; the financial impact of the proposed valuation is real and significant. It can be safely assumed that long term application of the proposed valuation would result in more plans that are underfunded. The implications for pensioners are sobering. When a plan is terminated, it could be "fully funded" according to the proposed Improved Funding valuation, but, in fact, it would be unable to fully meet its obligations on plan termination. That means that pensioners would be facing a reduction in pension payments. That amount would be even greater if the plan was underfunded according to the proposed funding valuation.

It is of note that the Report recommends use of the solvency valuation when determining eligibility for a contribution holiday. That recommendation seems to signal that the solvency valuation is crucial to long-term funding policy. With that we would agree. We strongly disagree that the solvency valuation should be abandoned for purposes of setting minimum funding targets, as is contemplated in Recommendation no. 4. Rather, solvency valuations should continue to be used for setting minimum funding targets, and the five year amortization period should be retained. The proposed valuation is imposing a real, significant, and unacceptable risk to all pensioners. And that risk may well be realized, through pension payment reductions, by every member of a pension plan that is wound-up should these proposals come into effect.

The proposed rule only appears to address the issue of plan under funding. What is crucial is that the reality of plan under funding must be addressed. The way to do that is to set standard funding rules that can be expected to meet the actual obligations of the plan, which must consider those obligations of the plan should it be terminated. If some sponsors have financial difficulty accommodating those funding requirements, then alternative temporary arrangements can be made, as discussed under Recommendation No. 3. To address just the appearance of underfunding by setting an inadequate funding standard will ultimately prove to be harmful to pensioners and, since the proposed valuation touches upon all Quebec based pension plans, it could prove to be harmful to the economic well being of all Quebecers.

Recommendation no. 5

CFP regretfully notices that the Report recommends squarely abandoning the solvency test, for all defined benefit pension plans, currently used for the determination of plan funding. However, the Report does explicitly recognize the value of such test when recommending that "it should be used to control the use of excess assets for all defined benefit pension plans under the supervision of the Régie des rentes du Québec."

If the solvency test is appropriate to determine excess assets, why is it not appropriate to determine a deficit?

Unfortunately, the conclusion here is pretty obvious, and this is recognized clearly in the Report: "the solvency test would not be used to determine deficit funding".

Since, invariably, solvency deficits are greater than capitalization deficits; deficit funding will be reduced accordingly. As a consequence, pensioners (especially those of the private sector) will assume a more important risk of loss of revenues in the case their plan would be in deficit and the plan sponsor would be bankrupt. This consequence, the Nortel retirees, unfortunately, had to face it recently.

Even more, since the results of the solvency test would not be taken into account anymore in the determination of pension plan funding levels, it's likely that at in the event of termination of a plan, the test will show that the plan in question is in deficit.

If a plan is allowed to be funded at a level less than that implied by the solvency valuation, then it will almost certainly be under funded when it is terminated. Once again, pensioners will have to pay the price.

Recommendation no.7

CFP notes that the OECP (Ontario Expert Commission on Pensions) report recommended that a surplus (relative to full solvency) of 25% be left in the plan.

> Recommendation 4-18 - Sponsors may apply to withdraw surplus from an ongoing plan pursuant to the procedures set out in Recommendation 4-16, provided that the plan remains funded subsequent to withdrawal at 125% of full solvency funding, or 105% of full solvency funding plus two years of current service costs, whichever is greater.

Recommendation no. 8

CFP fully subscribes to this recommendation. Nevertheless, it would be appropriate to reinforce the communication of this more than pertinent information to the active participants and retirees of these plans.

Recommendation no. 10

CFP supports this recommendation.

Recommendations no. 14 and no. 16

For retirees, these recommendations contemplate negotiations between the employer and its retirees concerning the indexation provisions of the DB plan. Specifically, the employer could reduce or eliminate the indexation provisions of the plan. To assure that such changes are not put into effect immediately, 30% of retirees would have to object to the changes. If the retirees were to meet this threshold and thereby reject the plan, the changes could nevertheless be put into effect unilaterally by the employer after three years.

Consider the scenario contemplated in these recommendations. An individual accepts work from an employer in 1971 and retirees in 2010 with 40 years of service. Throughout that time he is told that in addition to his salary, he will receive an indexed pension once he retires. In 2015, he is approached by his employer who suggests that his pension indexation will cease, going forward. As this is clearly not to his benefit, nor to the benefit of any of his retired colleagues, he expresses his objection to the employer. In fact, for purposes of this scenario, let us assume he is able to inform his retired colleagues that they too must express their objection, and at least 30% of them do so. In 2018, the employer nevertheless eliminates the indexation provisions, starting in that year. Part of the compensation he had been promised throughout his 40 years of work is being removed, specifically the indexation that should have applied for the years 2018 and following.

Would anyone consider it reasonable that the retiree should be informed in 2018 that the employer has decided, retroactively, that he had been overpaid through the 1971 through 2010 period and was therefore going to take back part of his salary? Surely not. But this is exactly what the recommendations are proposing. They put into place a unilateral mechanism that effectively denies the retiree part of the agreed compensation for the years 1971 through 2010. That the change can only be put into effect going forward simply limits the unfairness, it does not remove it.

There is nothing to prevent any employer from managing its pension expenditures by coming to a new arrangement with its employees, going forward. This is the common practice when it comes to the salary component of the compensation package. Changes are made, and have effect on a going forward basis.

On the other hand, recommendations 14 and 16 are an open invitation to employers to lower their pension obligations by cutting the benefits to retirees that had been promised to them throughout their working lives. As was discussed above regarding intergenerational equity, there is a world of difference between changing the compensation for work that has already been given, and changing compensation for work that has not yet been rendered to the employer. The latter is commonplace; the former is an abrogation of promises already made, a denial of contractual agreements. It is the antithesis of protecting the pension promise.

It may be thought that indexation provisions tend to be expressed as small adjustments made in a year, and so the impact on the individual is likely to be small. The first statement is true; the second is not. These small adjustments, over time, have significant impact. Even with modest indexation provisions, indexation may easily represent one quarter or more of the plan's liability. These recommendations, if put into effect for a plan registered in Quebec, would mean that over their retirement years, retirees would see their pensions reduced, regardless of what had been promised to them.

Recommendations 14 and 16 should be rejected. It is always open to employers to negotiate with their employees on ways to reduce their pension obligations going forward.

These two recommendations should be rejected in their entirety. Hence, the question of how to assess pensioner agreement is moot. However, should at any time the government contemplate gauging pensioner agreement, we question the approach that requires more than 30% of pensioners to object to a proposal before it can be defeated.

In the context of affording an equal opportunity to make its case, the parties involved in advocating to pensioners are not on an equal footing. The plan's sponsor is well aware of all individuals who have a stake in the issues, and have the necessary information to reach them. On the other hand, it is unlikely that any pensioner organization would even know who all of the plan's members are, let alone have the requisite information to reach them all. Indeed, it may well be the case that for some plans, no pensioner organization exists at the time proposals would be made to reign in plan benefits. The process for gauging pensioner support, or lack of support, is not a straightforward matter. CFP would be anxious to contribute to the development of an effective process should the government find it necessary to seek pensioners’ individual input.

Appendix

Affiliate Associations - Canadian Federation of Pensioners

- Air Canada Pionairs
- Bell Pensioners’ Group (BPG)
- CCRetirees Organization
- DuPont/Invista Pensioners Association Canada (DIPAC)
- GENMO Salaried Pension Organization
- International Association of IATA Retirees
- Municipal Retirees Organization Ontario (MROO)
- Nortel Retirees and Former Employees Protection Canada (NRPC)
- Novartis/Ciba Retirees Group
- Regroupement des employés retraités de White Birch-Stadacona (RERWBS)
- Rio Algom Salaried Retirees
- SCRG, a Sears Canada Retiree Association
- Slater Steel Pensioners
- Stel Salaried Pensioners Organization (SSPO)
- The Society of Energy Professionals - Pensioners' Chapter