Submissions In Response to the Federal Department of Finance's Consultation Paper entitled *Strengthening the Legislative and Regulatory Framework for Defined Benefit Pension Plans Registered under the Pension Benefits Standards Act, 1985*

Introduction

The Canadian Association of Counsel to Employers ("CACE") was created in 2004 as an association of lawyers who act on behalf of employers in labour and employment matters. One of CACE's primary purposes is to provide governments and regulatory bodies with input concerning policy and legislative reform from the perspective of its members and their clients.

CACE believes that the development of a legislative and regulatory climate that fosters the voluntary creation and maintenance of defined benefit pension plans is an important public policy objective. CACE applauds this consultation initiative of the Financial Sector Division of the Department of Finance, and is grateful for this opportunity to provide submissions addressing how the legislative and regulatory framework for defined pension plans registered under the *Pension Benefits Standards Act, 1985*[1] (the "PBSA") can be strengthened.

Guiding Principles

CACE's position on specific issues raised in the Department of Finance's May 2005 Consultation Paper are informed by certain fundamental principles, which we submit should guide review of the legislative and regulatory framework for defined benefit pension plans. These Guiding Principles, which are discussed in greater detail below, are:

i. *Keeping the Pension Promise*
ii. *Minimizing Disincentives for Establishing and Funding Defined Benefit Plans*
iii. *Ensuring Certainty and Predictability*
iv. *Balancing Certainty with Flexibility*
v. *Transparency of Plan Status*

[1] R.S.C. 1985, c. 32 (2nd Supp).

i. Keeping the Pension Promise

The ultimate objective of defined benefit pension plans is to provide guaranteed retirement security to plan members and their spouses. The certainty of receiving a fixed and secure stream of income after retirement enables employees to plan their working life and retirement with confidence that they will not outlive their retirement savings. The employer bears responsibility for designing and funding the plan, retaining investment professionals to manage plan assets, and ensuring that plan assets are sufficient to pay the promised benefits. To achieve this objective, the legislative and regulatory framework must promote both the proper funding of defined benefit plans, and the financial viability of the enterprises sponsoring those plans. Ultimately, the best insurance for members' benefits may be a financially healthy employer that is able to withstand economic downturns.

ii. Minimizing Disincentives for Establishing and Funding Defined Benefit Plans

By providing guaranteed retirement security to members and their spouses, defined benefit pension plans play a critical role in Canada's retirement income delivery system. These plans place the burden of ensuring that retirement fund assets are sufficient and professionally managed on the employer, who bears the associated risks and responsibilities. Defined benefit plans often provide an adequate source of retirement funds for those who would otherwise turn to the government safety net for retirement income. Defined benefit pension plans further aid the economy by promoting employee retention and providing a ready source of professionally managed investment capital. It is therefore important that the legislative and regulatory environment promote, rather than discourage, the creation and maintenance of defined benefit plans. Legislative and regulatory rules that impose unnecessary burdens and uncertainty on plan sponsors serve as disincentives, thus transferring the burden of delivering retirement income to less efficient vehicles such as public pension plans and individual savings.

iii. Ensuring Certainty and Predictability

Certainty and predictability of funding and administrative requirements are crucial to an enterprise's ability to maintain its pension promises through difficult economic times. Volatility in defined benefit funding costs is disruptive to an enterprise's ability to plan based on cash flow and liability projections. Costs associated with defined benefit plans therefore must be as predictable as possible. Similarly, an employer's funding obligations and rights with respect to fund surplus should be clarified in a manner that encourages employers to make additional contributions in good economic times to create a funding cushion for bad times.

iv. Balancing Certainty with Flexibility

While certainty and predictability are important values in the funding and administration of defined benefit pension plans, the regulatory framework must leave room for flexibility and the exercise of discretion in appropriate cases. CACE believes that it is important to balance the need for certainty with the exercise of discretion within defined guidelines in appropriate cases, taking into account the unique circumstances of the plan at issue. Similarly, while benefits that are already earned must be absolutely protected, plan sponsors must continue to be afforded the flexibility to adjust to changing circumstances by, for example, increasing or decreasing benefits to be earned in the future.

v. Transparency of Plan Status

CACE believes that plan participants are entitled to receive the information necessary to evaluate their retirement security. Plan participants therefore should be provided clear, timely and high quality data about the funded status of their plan. However, a commitment to transparency should not result in the dissemination of information that could prejudice the economic interests of the plan sponsor and thereby, the interests of plan members themselves.

<u>Responses to the Specific Issues Identified by the Government of Canada</u>

CACE draws on these Guiding Principles in responding to the specific questions and issues identified by the Government of Canada for consultation. The comments below do not constitute an exhaustive review of the views of our members and clients. Instead, we have focused on key, priority issues facing sponsors of federally-regulated defined benefit pension plans.

1. “***The Government of Canada is seeking views as to whether there are any disincentives or obstacles preventing plan sponsors from adequately funding their plans and building up a funding cushion.”***

CACE perceives the primary obstacle preventing plan sponsors from adequately funding their plans and building up a funding cushion as the sponsor’s inability to claim a refund of surplus and to utilize surplus to fund the obligations of the plan over the long-term.

A significant imbalance exists between the obligations and rewards to sponsors of defined-benefit plans. A plan sponsor is responsible for funding deficits, but is virtually unable to access plan surplus, either from a continuing plan or upon wind-up. An employer’s burden of establishing its legal entitlement to plan surplus based on historical plan documents can rarely be met (discussed further, below). In CACE’s view, a plan text which is silent, ambiguous or contradictory regarding surplus ownership should not be interpreted so as to disentitle the plan sponsor from accessing surplus, especially in the case of non-contributory plans, which are entirely employer-funded.

CACE acknowledges the “deferred wage” theory advanced by unions and other employee groups that pension benefits constitute a form of deferred compensation for which employees accept lower wages and benefits during their working career. It is beyond the scope of this paper to exhaustively rebut the reasoning underlying the deferred wage theory, however, CACE states that even taken at its highest, the deferred wage model does not support a default rule that plan members own actuarial surplus. The amount of any “deferred wage” should be construed as being limited to the defined benefit amount promised by the employer upon retirement, not any surplus amounts which are generated by the investment of contributions, or the use of conservative actuarial assumptions by the plan sponsor. The limited relevance of the deferred wage theory on surplus ownership issues was discussed by Justice McLachlin (as she then was) in her partly dissenting judgment in *Schmidt v. Air Products Canada Ltd.*[2] as follows,

> **It is argued that employees should have the surplus because they have paid for it through direct contributions or by accepting lower wages and fewer fringe benefits. This argument overlooks the nature of the employees' legitimate expectations under a defined benefit plan. The employees, having bargained for specific benefits, will receive precisely what they bargained for. The benefits, as defined by the plan, are the quid pro quo for their services and contributions. Indeed, the intention of the parties -- and the very purpose of the plan -- is that they receive these benefits. To give the employees the surplus, however, is to give them more than they bargained for. It is a windfall to the employees and a denial of the equitable interest which the employer holds in the surplus….(paragraph 185)**

CACE agrees with this view.

The existing obstacles to creating funding "cushions" would be exacerbated by adoption of an interpretation of the Supreme Court of Canada's recent *Monsanto* decision which would require federally-regulated plans to distribute a *pro rata* share of surplus to members affected by a partial wind-up. No sponsor would want to commit funds to create a "cushion" which will be paid out as a windfall to plan members departing the plan following corporate restructuring or any other prescribed event. These surplus ownership issues, especially in relation to the surplus dispute mechanism and the *Monsanto* decision regarding partial plan terminations, are discussed in further detail below.

Uncertainty surrounding surplus attribution, distribution and entitlement rules provides an incentive for employers to underfund plans, thereby minimizing the potential for surplus at any time in the future. More generous funding would not only generate surplus, it is likely to generate protracted litigation and extended periods of uncertainty regarding the financial status of the plan. To counter these obstacles, CACE urges the Government of Canada to enact legislation consistent with the principles set out in this document that will remedy what is

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[2] [1994] S.C.J. No. 48 (QL)

becoming an increasing hostile regulatory environment for sponsors of defined-benefit pension plans.

2. "***The Government of Canada is seeking views on whether the dispute settlement mechanism for surplus distribution contained in the PBSA requires improvement or clarification."***

Under the current legislation, an employer is required to demonstrate a legal entitlement to surplus or obtain consent of two-thirds of affected parties as a condition precedent to the Superintendent of Financial Institutions consenting to the withdrawal of any of the surplus. There are also related notice and procedural requirements contained in the *PBSA*.

CACE is of the view that the notice provisions do not require substantial amendment because they are consistent with the general policy of transparency which we regard as an important component of the *PBSA*.

CACE has concerns, however, with respect to the burden placed on an employer to establish its legal entitlement to plan surplus. As indicated in the Department of Finance's Consultation paper, many older pension plans were silent on the issue of surplus, or contained ambiguous or conflicting language. In our experience, the problems with older plans arose because the parties who drafted the plans did not see surplus as a significant issue.

Under the current *PBSA*, the employer must engage in a forensic reconstruction of all prior versions of the trust agreements. In many cases it is very difficult to obtain all of the relevant documents. Complex questions arise in situations where amendments relating to surplus ownership have been made during the life of the plan. For most employers who have older plans, it is virtually impossible to establish a clear entitlement to surplus. This creates an incentive to avoid creating surplus.

Also, in resolving surplus disputes, the courts have tended to focus on principles of classic trust law, both with respect to whether pension funds are impressed with a trust in the first place and if so, whether the created trust is revocable or irrevocable. In the event an irrevocable trust is created in favour of plan members, the plan sponsor is essentially unable to access surplus funds.

This is the case even where the employer initially reserves a broad plan amendment power and purports to exercise that power to authorize its withdrawal of surplus assets. Placing a critical emphasis on the distinction between a revocable and irrevocable trust disregards the overarching influence of the income tax regime on pension plan design and administration. Prior to 1981, employers were entitled to tax relief on funds designated for employee pensions only if those funds were committed *irrevocably* to a trust or some other funding arrangement. Subsequently, the taxation rules changed so as to place limits on employer contributions to pension funds and to require reversion to the employer of assets in excess of those needed to fund statutory benefit maximums. In essence, this requires the creation of a *revocable* trust in relation to a portion of plan assets. These shifting taxation rules have led to confusion about the nature of pension trusts and created a significant volume of surplus entitlement litigation. CACE submits that a motivation to ensure vigilant compliance with taxation requirements must not defeat a plan sponsor's ability to claim plan surplus and urges the federal government to displace the courts' traditional emphasis on the wording of individual pension plans with appropriately-worded legislation.

In the *Schmidt* case, the Supreme Court of Canada acknowledged the need for comprehensive legislation to resolve the myriad of complex issues relating to surplus entitlement:

> **…Regrettably, a comprehensive approach to the issues arising from pension surplus has yet to be enacted in any part of this country. The courts have on a number of occasions been required to determine the allocation of pension surplus. Yet the courts are limited in their approach by the necessity of applying the sometimes inflexible principles of contract and trust law. The question of entitlement to surplus raises issues involving both social policy and taxation policy. The broad policy issues which are raised by surplus disputes would be better resolved by legislation than by a case-by-case consideration of individual plans…(at paragraph 39)**

In our view, surplus ownership legislation should be structured so as to encourage employers to fund plans generously. For example, if the plan was always 100% employer funded, then the employer will be entitled to surplus unless the existing plan expressly provides that surplus is to belong to plan members. An employer who has 100% funded the plan has a legitimate expectation that if it overfunds the plan, it will not be required to confer a 'windfall' benefit on the plan members.

With respect to plans that are funded by both employers and employees, consideration could be given to entitling employers and employees to surplus in proportion to their respective contributions during the period the surplus arise. In theory, this division of surplus plan assets could be made according to the actuarial reports filed on behalf of the relevant plan and two different surplus accounts could be created within the plan. CACE recognizes that this proposal poses some practical difficulties, since the Canadian Institute of Actuaries has not published a practice standard in relation to such a calculation, and because complications would arise if thorough contribution history documentation was unavailable. Despite these stumbling blocks, CACE believe that this approach merits further consideration.

Finally, CACE also wishes to express concern regarding the dispute resolution mechanisms provided for in the *PBSA*. It is our view that the mechanism which relies on the consent of affected parties to an employer's surplus withdrawal proposal is inherently flawed. Even where the employer has a very strong (although not iron-clad) argument that it enjoys full ownership of plan surplus, an incentive exists for affected parties (members, former members, etc) to refuse to consent to the proposal in hopes of negotiating an even more favourable surplus sharing arrangement. The consent mechanism clearly fails to provide a plan sponsor with greater certainty, any assurance of an equitable outcome, or even the avoidance of consequential negotiation and litigation. The arbitration mechanism is also undesirable in that it creates further expense for a plan sponsor and protracts the process leading to certainty of surplus ownership. It is not immediately apparent that the arbitration mechanism is any more appealing than proceeding before the courts to decide surplus ownership issues.

3. ***"The Government of Canada is seeking views on whether there should be partial plan terminations under the PBSA and if so, should there be a requirement to distribute surplus at the time of the partial termination."***

Currently, subsection 29(2) of the *PBSA* contemplates that plans may be terminated either in whole or in part where:

- there is any suspension of cessation of employer contributions in respect of all or part of the plan members;

- the employer has discontinued or is in the process of discontinuing all of its business operations or a part thereof in which a substantial portion of its employees who are members of the pension plan are employed; or

- the Superintendent is of the opinion that the pension plan has failed to meet the prescribed tests and standards for solvency in respect of funding

CACE is aware that the Quebec legislature opted in 2001 to completely eliminate partial wind-ups from its *Supplemental Pension Plans Act,* however, we are not aware of compelling policy reasons for the Government of Canada to follow suit.

Although partial plan terminations occur for a variety of reasons, the most common triggering event is corporate re-organization which results in the departure of a substantial portion of plan members. In such situations, we have no objection to the portion of the plan associated with those members being treated as terminated. CACE objects, however, to a requirement that surplus be distributed to the partial wind-up group at the time of termination.

CACE submits that a splitting of assets and liabilities between the terminated portion of a plan and the ongoing portion of a plan is appropriate where the plan as a whole is underfunded, but a distribution of surplus is inappropriate where a plan is overfunded.

In a scenario where unfunded liabilities exist at the time of partial plan termination, it may be appropriate for the pension regulator to step in, assess the situation and attribute a *pro rata* portion of the deficit to the departing members. Otherwise, the funded status of pension benefits of employees working for a company in spiralling financial difficulty may be determined largely based on the order in which each division is eliminated, rather than in a more equitable manner which protects the interests of all plan members equally.

In a scenario where a plan's funding is at equilibrium in relation to its liabilities at the time of partial plan termination, CACE questions whether an actual plan termination is necessary, however, such a requirement does not appear to constitute an overly onerous compliance measure.

In a scenario where actuarial surplus exists at the time of partial plan termination, CACE submits that distribution of surplus is inappropriate from a pension policy perspective. Unquestionably, the plain and ordinary meaning of the statutory provision at issue in *Monsanto* was determinative of the outcome in that case, however, we submit that from a policy perspective, it is open to the Government of Canada to override the view that plan surplus is necessarily a "windfall" that is "…not within the expectations of either the employer or employees…"[3] and that requiring distribution of surplus "…is unlikely to compromise the continuing integrity of the pension fund…"[4]

To the contrary, generation of surplus is a predictable result of the cyclical nature of the economy, discussed below, and is largely generated by the use of conservative, as opposed to more liberal, actuarial investment performance assumptions. The Government of Canada should be wary of endorsing an approach to plan surplus that is premised on the concept of surplus being a pure "windfall" to the plan, as opposed to an expected financial cushion that is needed by continuing members.

The potential inequities of requiring *pro rata* surplus distribution upon partial plan termination are readily apparent. Members who retire shortly before a partial plan termination would receive no portion of surplus, whereas those who retire in conjunction with the partial plan termination share in potentially a large windfall. Furthermore, if surplus is distributed in accordance with each member's wind-up liabilities, members with greater accrued benefits would be further rewarded by a greater entitlement to surplus. Since the financial position of the plan during each member's period of benefit accrual is unlikely to be considered, apportionment of surplus is unavoidably arbitrary, based only on a snapshot of the funding position of the plan at the time of partial termination. Any of these approaches fail to take all plan members' interests properly into account.

[3] *Monsanto Canada Inc. v. Ontario (Superintendent of Financial Services)*, 2004 SCC 54 at para. 42
[4] *Ibid.* at para. 40.

It is our experience that plan members involved in partial wind-ups are generally older employees with greater accrued benefits, while continuing members tend to be more junior. More junior members, and continuing members more generally as a group, have a greater stake in the ongoing financial performance and funded status of a pension plan. Due to the cyclical nature of the economy and in particular, investment returns, a plan sponsor will be called upon to weather a number of significant financial downturns and even perhaps a major restructuring of their industry during the employment cycle of a continuing plan member. This recurring cycle offers compelling policy reasons to create and maintain a funding "cushion" to protect the interests of continuing plan members rather than to distribute surplus as a windfall to a group of members leaving the plan.

In the case of non-contributory plans, it is clearer that paying surplus to departing plan members is a windfall in their hands, however, even in relation to a plan jointly funded by employer and member contributions, surplus should be preserved as a matter of prudence to protect the interests of continuing members. In our view, distribution of surplus upon partial plan termination inappropriately insulates a departed group of members from all future financial risk at the expense of preserving the financial cushion for continuing members. In contrast, the "wait and see" approach which requires a distribution of surplus only upon full plan termination, strikes a more appropriate balance between the interests of all plan members.

CACE Recommendation

Absent federal legislative intervention, the Courts are likely to interpret subsection 29(12) of the *PBSA* as requiring the distribution of surplus mandated under Ontario's *Pension Benefits Act* in *Monsanto.* This is due to the similarity in wording between subsection 29(12) of the *PBSA* and subsection 70(6) of the Ontario legislation, as well as the common purposes and features of the two legislative regimes. CACE recommends that legislation be enacted which overrides the holding in *Monsanto* in order to establish a more balanced regulatory environment under the *PBSA* than now exists under Ontario's *Pension Benefits Act.*

We note that Alberta's *Employment Pension Plans Act*[5] states at section 75:

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[5] R.S.A. 2000, c. E-8

Entitlements on partial termination

75**(1)** Subject to subsection (2), where only part of a pension plan is terminated, the entitlements of members and former members affected by the partial termination are not less than those to which they would have been entitled had the whole of the plan been terminated on the date of the partial termination.

(2) Subsection (1) shall not in itself be construed as entitling any person affected by the partial termination to share in any distribution of the surplus assets on the partial termination of the plan, but the plan may provide such entitlements.

[Our emphasis]

Similarly, British Columbia's *Pension Benefits Standards Act*[6] provides at section 53:

Entitlements on partial termination

53 (1) 1f only part of a pension plan is terminated, the entitlements of members and former members affected by the partial termination must not be less than those to which the members and former members would have been entitled had the whole of the plan been terminated on the date of the partial termination.

(2) Subsection (1) does not entitle a person affected by the partial termination of the plan to share in any surplus assets on the partial termination, but the plan may provide for such an entitlement.

[Our emphasis]

CACE recommends that the Government of Canada implement the same balance that has been struck by the legislatures in Alberta and British Columbia regarding member entitlement to surplus upon partial plan termination. We recommend qualifying the general rule set out in subsection 29(12) of the *PBSA* to state that distribution of surplus on partial plan termination is only required if the plan text so provides.

[6] R.S.B.C. 1996, c. 352

4. ***"The Government of Canada is seeking views on whether there are alternative financial vehicles, such as letters of credit, that could allow for greater funding flexibility.***

What types of conditions or rules should be required if greater funding flexibility is given to plan sponsors, to ensure that the risk to benefit security is minimized?"

CACE recognizes that this issue involves broad consideration of both pension law and commercial law. If the alternate funding vehicle was to hold a first ranking charge on the assets of the employer, this would put the plan effectively in the position of being a "secured lender" to the employer. This raises a host of debtor-creditor issues including competing security interests, statutory priorities for unremitted source deductions, etcetera. Due to the complexity and difficulty of ensuring that the pension promise enjoys a first charge, we have significant reservations about this type of funding vehicle.

However, drawing on the Guiding Principles of balancing flexibility with certainty, keeping the pension promise and minimizing disincentives for funding defined-benefit plans, CACE is cautiously in favour of permitting alternate funding vehicles under the *PBSA*. Allowing sponsors to fund solvency deficiencies via alternatives to cash contributions may be a pragmatic and reasonable approach to balancing a plan sponsor's deficiency funding requirements against plan members' desire for benefit security. Incorporating this flexibility into the *PBSA* prevents a plan sponsor from having to divert cash funds away from maintaining or expanding business operations. Since the fee charged and the maximum credit limit granted by a financial institution depends on the credit-worthiness of the plan sponsor, letters of credit are likely to be unavailable (or excessively expensive) to plan sponsors who are experiencing extreme financial difficulty, thereby reducing the opportunity for their inappropriate use.

CACE submits that certain regulatory constraints are appropriate in order to further ensure effective and appropriate use of alternate funding mechanisms. In the case of letters of credit, which is the example referred to by the Government of Canada, appropriate conditions are that:

- The plan trustee, not the plan sponsor, must be the beneficiary of the letter of credit;

- The letter of credit must be exercisable by the trustee unilaterally, meaning that the trustee is able to convert the letter of credit into cash without the prior consent or action by the sponsor. Any scenario that requires the plan sponsor's consent would create disputes about whether the necessary triggering conditions are satisfied. Such disputes would create unacceptable uncertainty in plan funding;
- The letter of credit must be issued by a chartered Canadian financial institution that deals with the plan sponsor at arm's length; and
- If the letter of credit has a defined time limit, it should automatically convert into cash if it is not renewed at some reasonable time prior to its expiry date. For example, if not renewed within 90 days of its expiry, a letter of credit would automatically convert into a cash contribution to the plan. By creating this default scenario, the plan will not be placed in a shortfall situation from the security expiring because the trustees were uncertain whether it should be converted into cash.
- Consideration should be given to placing a cap on the maximum level of contributions that can be secured by an alternate funding vehicle. For example, letters of credit could be permitted only to cover the excess of minimum solvency contributions over minimum going-concern contributions

By imposing these restrictions, the Government of Canada would address many of the policy concerns recently identified in *Butler Brothers Supplies Ltd.* v. *B.C. Superintendent of Pensions Financial Institutions Commission*[7] regarding the use of letters of credit to fund pension plan solvency deficiencies. In that case, the British Columbia Court of Appeal held that a letter of credit does not qualify as a pension plan asset under British Columbia's *Pension Benefits Standards Act*. In support of this finding, the Court of Appeal noted that the letter of credit in question was held by the employer, not the plan, and could not be called upon by the plan trustees. The above-noted restrictions would address these concerns. An additional concern expressed by the Court of Appeal was that letters of credit cannot be considered plan assets because they cannot be invested to earn income for the pension fund. Although meeting this criteria was a requirement in *Butler Brothers Supplies* due to the wording of the legislation at issue, CACE submits that no principled basis exists to maintain such a narrow definition of plan

[7] [2005] B.C.J. No. 1387 (C.A.)

assets. An essential advantage for plan sponsors of letter of credit funding is that it provides benefit security to plan members in the event of insolvency or other events without creating the risk of surplus creation in other circumstances. In essence, a key feature (not drawback) of a security instrument is its "non-investment" nature as an asset. Acknowledging that greater flexibility in deficiency funding is warranted requires a shift away from the current, overly narrow conception of plan assets to a broader view.

5. ***"The Government of Canada is seeking views on what the appropriate amortization period is and whether it is different for financially vulnerable and financially strong companies. The Government of Canada is seeking views on what types of conditions or rules should be attached to any extended amortization period for solvency funding for companies under CCAA or BIA."***

CACE notes the recent legislative initiatives to extend amortization periods for Quebec and New Brunswick-registered plans and supports the Government of Canada granting the federal pension regulator a limited discretion in this regard.

Strong policy reasons exist for permitting a plan sponsor to amortize its solvency deficiency funding payments over a period longer than five years during periods of low interest rates, since a large portion of the apparent shortfall will be reduced once interest rates increase and more favourable actuarial assumptions are used to calculate the funding position of the plan. Forcing plan sponsors to aggressively fund deficiencies over a short time span when higher interest rates and improved investment returns await "around the corner", so to speak, creates a strong disincentive to the creation and maintenance of defined-benefit pension plans.

CACE submits that a presumption should be created under the *PBSA* that, upon filing appropriate documentation, a plan sponsor will be granted a ten year amortization period as a matter of ordinary course. This policy choice avoids placing an undue burden on plan sponsors in the face of historically low interest rates or other anomalous periods. Even longer amortization periods should be available in extraordinary circumstances.

For financially vulnerable corporations, CACE submits that an amortization period shorter than ten years should be imposed if the pension regulator can establish that doing so more appropriately protects the viability of the plan as a whole, and the interests of those members with long service, in particular. It is our view that the pension regulator's discretion must be sufficiently broad so as to ensure maximal protection of members' interests. Granting the discretion to either shorten *or* lengthen the relevant amortization period in exceptional circumstances creates the needed flexibility.

CACE recognizes that any relaxation of funding requirements must be accompanied by conditions carefully crafted to protect plan members' interests against the risk that the plan sponsor will fail before the plan's solvency deficiency has been eliminated. We support broader use of the conditions imposed in the Air Canada scenario, which included extensive beneficiary notification, participation and consent, as well as limitations being placed on benefit improvements which could compromise the sponsor's ability to provide full benefits under the plan. These conditions are consistent with the Guiding Principles of transparency, keeping the pension promise and balancing flexibility with certainty.

6. *"The Government of Canada is seeking views on whether there are alternatives to address funding issues other than relaxing funding requirements. For example, would special accounts for pension plans be feasible"*

The proposal to create notional special accounts highlights the deficiencies in the current law relating to surplus ownership. If entitlement to surplus was clearly vested in the employer, then special accounts would not be required. Bearing this comment in mind, it is CACE's view that creating special notional accounts for the deposit of deficiency funding payments may be a useful means to provide sponsors with the flexibility needed to ensure access to funds in excess of the plan's needs. This proposal, however, should be considered as a complement to relaxing funding requirements, not as a substitute. As identified by the Government of Canada in its consultation paper, extending the solvency funding period can reduce a company's annual pension payments to a level that facilitates its emergence from bankruptcy protection, a result which is likely to be in the best interests of plan beneficiaries as a group. Replacing this approach with a special notional account fails to protect plans sponsored by companies in the throes of restructuring.

As indicated above, the proposal to create notional special accounts raises the more general issue of certainty regarding ownership of surplus. Allowing solvency deficiency payments to be deposited to a more accessible special account may create an incentive for sponsors to underfund plans in order to routinely access any subsequently generated surplus. As a matter of consistent policy, a sponsor should be certain of its entitlement to all surplus, not only surplus that arises after a period of plan underfunding.

7, “***The Government of Canada is seeking views on whether there should be greater disclosure provided to plan members regarding a plan sponsor’s financial condition, funding decisions and contribution holidays and how this may be done.”***

CACE takes no position on this issue.

8. ***“The Government of Canada is seeking views on its proposal to implement the void amendments of the PBSA based on a prescribed solvency ratio level of 85 per cent, and to reduce the priority of claims against pension plan assets for recent benefit improvements that have not been fully funded. Specifically:***

- ***Is an 85 per cent solvency ratio an appropriate threshold for applying the proposed controls and conditions on plan improvements?***
- ***Should pension plans with solvency ratios below 85 per cent be permitted to make plan improvements provided that offsetting funding is provided at the time that the improvement comes into effect?***
- ***Would the proposed priority scheme improve security of longer-established benefits?”***

CACE has no objection to the proposed threshold of an 85% solvency ratio triggering the proposed controls on plan improvements. We agree that plans with solvency ratios below this level can generally be considered significantly underfunded and that it is reasonable to apply restrictions and conditions on benefit improvements by such plans.

We also agree that in limited circumstances, the pension regulator should be empowered to authorize benefit improvements by plans with solvency ratios less than 85%, however, we are concerned that the example cited by the Government of Canada could create excessive uncertainty for plan members. If plan improvements are approved contingent on offset funding being provided by the plan sponsor at the time that the improvement comes into effect, plan members will be subjected to uncertainty about whether the approved enhancements actually will be implemented as proposed. Although we favour granting sponsors flexibility in structuring plan design and implementing improvements, this proposal could create undue uncertainty.

CACE submits that flexibility should be created within the *PBSA* to enable amendments to be approved in appropriate circumstances, notwithstanding a plan's solvency ratio falling below 85%. To this end, the pension regulator should retain the discretion to approve benefit improvements in extenuating circumstances. We emphasize that this discretion must be exercised in a manner consistent with the Guiding Principles set out above, in particular, the need to protect the basic pension promise and provide plan members with appropriate disclosure and certainty regarding their future benefits.

CACE is cautiously supportive of the Government of Canada's proposed priority scheme, which we agree would improve the security of longer-established benefits. Creation of a priority scheme could also assist a financially distressed plan sponsor to go forward on a more financially sound basis. We are concerned, however, that giving lower priority to recent plan improvements in the event of a deficit at plan termination may not benefit plan members as a whole. Depending on the demographics of plan membership, preserving the priority of longer-established benefits may unduly reward a minority of members at the expense of the majority. Discretion should be retained to allow the pension regulator to deviate from the default priority scheme as required by the needs of a particular plan.

9. ***"The Government of Canada is seeking views on full funding on plan termination, and in particular how it should be applied to financially vulnerable sponsors".***

CACE recognizes that the *PBSA* is unique in its treatment of a plan sponsor's funding obligations upon plan termination. We note that the vast majority of plan termination scenarios arise in the context of insolvency, not circumstances of a plan sponsor's financial health. In practical terms, a key issue for employees is their ability to claim secured creditor status during insolvency proceedings and therefore take priority over other categories of creditors. We understand that amendments to the *Bankruptcy and Insolvency Act* are currently under consideration to address this important issue.

CACE shares the Government of Canada's concern that requiring financially vulnerable sponsors to provide full funding on plan termination may be counterproductive to the interests of plan members themselves and would contradict many, if not all, of the Guiding Principles discussed above. The likely result of imposing full funding requirements on a financially vulnerable employer would be to dramatically increase the likelihood of permanent insolvency. It is difficult to see how this would benefit current members in most circumstances.

10. ***"The Government of Canada is seeking views on the viability of a federal pension guarantee fund including any comments on its possible design, operation, and powers."***

Beneficiaries of defined benefit pension plans run the risk that the plan sponsor will become insolvent while the plan is underfunded, resulting in the loss of retirement income. One method of increasing the security of defined pension benefits is through the establishment of a pension benefit guarantee arrangement, which would cover lost pension benefits in such cases. However, CACE believes that the significant drawbacks to such an arrangement – particularly in Canada's federal sector – outweigh the potential advantages, and that concerns about the security of pension benefits can be better addressed through other measures.

As the Department of Finance notes at page 13 of the Consultation Paper, plans registered under the *PBSA* account for only 10 percent of pension plan assets in Canada, with 10 plans accounting for more than 60 percent of the assets. The statistics set out in the Annex to the Consultation Paper indicate that as of March 31, 2005, there were only 428 defined benefit pension plans within the federal jurisdiction, covering 482,605 members. CACE submits that the number of potential contributors to a pension benefits guarantee fund in this sector is too low to distribute the risk efficiently.

More generally, CACE is concerned that the increased cost to plan sponsors through insurance premiums could act as a financial disincentive to establishing and maintaining defined benefits funds, and could contribute to the shift from defined benefit to defined contribution plans. The likelihood of premium increases over time would become a source of volatility and burden for employers, particularly those struggling to recover from an economic downturn. Premiums would also divert resources away from other important purposes, including higher wages and capital investments.

Furthermore, as with any type of insurance, a plan sponsor may adopt riskier behaviour – such as pursuing a risky investment strategy – in response to the protection provided by a pension benefits guarantee fund, leaving other employers to cover the costs. CACE anticipates that if such an arrangement were introduced in the federal sector, financially stronger employers would inevitably end up subsidising weaker ones. While this concern could be addressed to some extent by carefully setting premium rates, fully risk-adjusted premiums likely would be too high to bear and could push vulnerable employers further toward insolvency. Meanwhile, financially secure employers would be motivated to convert from a defined benefit to a defined contribution plan in order to avoid shouldering an increasingly large proportion of the burden.

The significant adverse experience by the Pension Benefits Guarantee Fund (“PBGF”) in Ontario, the only fund of its kind in Canada, and by the Pension Benefits Guaranty Corporation (“PBGC”) in the United States suggest that implementing such a fund for federally-regulated plans is neither a feasible, nor a desirable policy option. The PBGF is likely to face claims in the range of $1 billion due to the insolvencies of Algoma Steel Inc. and Stelco Inc., against fund assets of approximately $222 million. Employer premiums are set to increase and the Ontario government has been forced to address the PBGF’s deficit by announcing $500 million in contingency financing. In the United States, the viability of the PBGC appears just as grim as that of its Ontario counterpart. Conservative estimates put the PBGC’s deficit at US$23 billion in the wake of fiscal crises in the airline sector.

Given the negative experience in Ontario and the United States, and the lack of possible reform measures to create a viable pension benefits guarantee fund, CACE strongly urges the Government of Canada to decline to create such a regime for federally-regulated plans. The failures of the Ontario and U.S. regimes are warning signals which, in our view, must be heeded.

As the Consultation Paper notes at page 3, the Superintendent of Financial Institutions considers the current funding situation for federally regulated defined benefit pension plans to be stable and manageable. In this context, CACE submits that concerns about the insecurity of retirement benefits can be addressed with appropriate funding and investment rules. The objective of strengthening retirement security should not be pursued in a manner that ultimately acts as a disincentive to establishing and maintaining defined benefit plans.

Conclusion

CACE submits that the specific comments in response to the Government of Canada's Consultation Paper, which give overarching priority to the Guiding Principles framework set out above, constitute a reasonable and prudent approach to the issues raised.

Most importantly, CACE is of the view that legislative action is immediately required to remedy the current state of the law regarding surplus ownership and rights upon partial plan termination. If action is not taken, CACE is concerned that the ongoing decline in defined benefit plans in the private sector will continue and perhaps accelerate. The Government of Canada should take action to address this serious issue in the interest of the general public and in the interest of the economy as a whole.

In closing, CACE submits that legislative reform is urgently required to increase the pension benefit accrual limits imposed by the *Income Tax Act.* Although this issue was not identified by the Consultation Paper for discussion, CACE believes it is an issue that requires urgent attention by the Department of Finance. Efforts to review the *PBSA* must not ignore the significant interplay with the taxation rules, in particular, the relatively low limits placed on funds that can accrue on a tax sheltered basis under a registered plan.

Prior to 2004, the maximum defined benefit accrual permitted under the *Income Tax Act* was $1,722.22 per year of service. That figure increased to $1833.33 per year of service for 2004, $2000.00 for 2005, and future increases will be indexed to increases in the average wage. These adjustments, put in place by the 2003 federal budget, constituted the first significant increase in the registered defined benefit limits since 1976.

Even with these recent increases, Canada lags significantly behind other jurisdictions by not effectively maximizing the amounts employees can save under registered plans. We understand based on publicly available data that defined-benefit accrual limits in comparative jurisdictions such as the United Kingdom and the United States are 50% to 140% higher than those imposed by Canadian tax law. The low Canadian limits have at least two detrimental impacts. First, for high income earners there has been a significant shift in emphasis from registered plans to benefit accrual under non-registered supplementary savings plans. To the extent that the *PBSA* and its provincial counterparts signal a public policy choice that employees are best protected by benefit accrual under registered plans, creating a shift to non-registered plans appears unwise. Second, the low benefit accrual limits create a competitive disadvantage for employers attempting to recruit and retain employees who otherwise may opt to work and save for retirement in jurisdictions with more generous savings limits within registered vehicles. CACE urges the Government of Canada to align the defined benefit accrual limits with those of jurisdictions such as the United States and the United Kingdom.

CACE wishes to express its gratitude to the Government of Canada for providing this opportunity to make submissions regarding the legislative and regulatory framework for federally-registered defined benefit pension plans.