Comments of the

Canadian Federation of Pensioners

regarding

A Review of the Solvency Funding Framework under the *Pension Benefits Standards Act*: A Consultation Paper

British Columbia

January 31, 2019

1.0 Introduction

The Canadian Federation of Pensioners (CFP) is pleased to provide its comments regarding British Columbia's *A Review of the Solvency Funding Framework under the Pension Benefits Standards Act.* CFP is an organization dedicated to improving the security of defined benefit (DB) pension plans in Canada. Each of CFP's 20 member organizations advocates for the interests of the active and retired members of workplace DB pension plans. Collectively, the CFP member organizations represent the interests of more than 250,000 individuals across Canada. The pension plans for two of those member organizations, representing Weyerhaeuser and Catalyst Paper pensioners, are registered in British Columbia, and a third representing Kodak pensioners, will be shortly.

CFP agrees that the four objectives of the review are legitimate goals to consider when improving regulations and provisions governing DB pension plan funding, and is gratified that the first of these is Benefit Security.

However, the stated definition of benefit security is in our opinion too limited, as it explicitly excludes the most usual situation where a plan is wound up—the insolvency of the sponsoring employer. The use of solvency funding is directly related to the fact that plans may be wound up at some time (for whatever reason). The solvency funding model is meant to provide, ideally, full pension benefits upon wind up through the purchase of annuities for each beneficiary using plan assets.

CFP strongly urges the B.C. Ministry of Finance to include consideration of sponsor insolvency when improving benefit security. A reduced pension benefit affects the recipient whatever the reason that triggers plan wind up.

CFP's submission is premised on sponsor insolvency being the main situation that needs to be considered when contemplating possible improvements to B.C.'s solvency funding framework. While bankruptcy is a rare event (1.1 per thousand businesses per year in 2017 according to the Superintendent of Bankruptcy), it is often catastrophic for pension plan beneficiaries.

CFP and its individual member groups have direct experience of the dire impacts that arise when underfunded plans are wound up due to sponsor insolvency.

- CFP was formed by pensioner organizations dealing with insolvency situations
- Four of our former or present member organizations (Slater Steel, Rio Algom, Nortel Networks, and Harmac Pulp (Pope & Talbot) retirees within

the MacMillan Bloedel Weyerhaeuser Retired Salaried Employees Club (BC registered plans)) have seen significant (30% or more) individual pension reductions as a result of insolvency-induced plan wind ups; Catalyst retirees had to surrender their Extended Health Benefits to protect their pensions in bankruptcy proceedings (also a BC registered plan)
- Store and Catalogue Retiree Group (Sears) will soon join them

CFP will first present our proposal that fully deals with benefit security in the context of B.C.'s Review. We will then briefly comment on the approaches and options provided in the Review. We will also comment on Modifying Commuted Value Transfer Rules and other measures.

2.0 CFP Proposal – A Group Insurance Model

CFP believes that the problems associated with pension funding, both for sponsors and plan members, cannot be readily solved within the existing framework and certainly not through the options presented in the Consultation Paper. The most financially efficient way to address these problems and to secure DB pension benefits even if a plan is wound up while in deficit (through sponsor insolvency or otherwise) is a robust group insurance model.

Such models are in place in a number of countries including the US, the UK and Germany. In Canada where responsibility for pension plans is divided between the Federal Government and individual provinces, Ontario has taken the lead by establishing a Pension Benefit Guarantee Fund (CFP's similar proposal is termed a Guarantee Fund (GF) model in this submission).

CFP recommends serious consideration of a GF model for British Columbia, based with necessary improvements on Ontario's design. CFP advocates for a considerably higher level of coverage than Ontario's $1500/month which is inadequate to cover the risk to which the majority of DB pension plan members are exposed. The Pension Benefit Guarantee Corp. in the U.S. covers up to just under $US60,000 per year; European models cover even higher amounts.

CFP has previously submitted our GF model to Ontario, Nova Scotia and Manitoba during their recent solvency funding reviews.

Let us describe our GF model more fully. The existing solvency funding requirement for pension plans in each pension jurisdiction is in essence an individual-plan self-insurance design. One can consider solvency funding requirements as the self-insurance "premium".

For rare risks like insolvency-induced wind up while a plan is in deficit, self-insurance requires much higher "premiums" and unnecessarily ties up corporate assets (which thus become unavailable for business operation and development purposes) when compared to group insurance (i.e. CFP's proposed GF model). Because we suggest that this model can and should replace solvency funding (which is now defined in each pension jurisdiction), CFP realizes that our GF model probably needs to be dealt with by each pension jurisdiction (federal + 9 provinces). There might be an opportunity for multi-jurisdictional deployment where existing pension laws are compatible.

Also, CFP's GF model allows for *full* insurance coverage at reasonable cost for all of any deficit that is revealed in a wind up, thus making all beneficiaries whole without prolonged anxiety (with attendant health care system costs) or recourse to government social programs. CFP asserts that the much lower GF model premium required (less than 10% of the existing solvency funding requirement, i.e. self-insurance "premium") means that plan sponsors in financial difficulties would be much less likely to be driven further into difficulty by special solvency payments after untoward solvency valuations.

Because group insurance premiums are appropriately based on wind-up risk, there is a built-in incentive for plan sponsors to minimize GF premium costs by ensuring plans are fully funded. To be clear, plans with large solvency deficits would and should pay larger GF premiums than plans with smaller deficits. (Plans that are fully funded on a solvency basis might still need to pay a modest administrative fee to continue their participation in the Guarantee Fund.) Of course, plans with more provident pension benefits would need to pay larger premiums to cover the richer benefits, and thus higher risks, being insured. This risk-based aspect of CFP's proposal also means that no government "bail-outs" are necessary. For companies, there is a large reduction in the uncertainty of solvency costs and special payments required if financial and pension circumstances change between valuations—one of the significant drivers of BC's solvency review and of the steady loss of active DB pension plans.

CFP would like to distinguish between private corporate pension plans and those in the public sector. The latter are not exposed to any significant risk of wind up while in deficit, and so should be excluded from GF coverage. They are intrinsically going-concern-only pension plans and can be funded on that basis alone.

CFP notes that in recent years, as a result of a number of high profile insolvencies that resulted in severe losses for pensioners, there have been growing demands for insolvency legislation (BIA, CCAA) to be changed to provide a higher creditor priority for pension obligations. Opposition parties have tabled bills aimed at doing so, and in response to this as well as pressure from pension advocacy groups the federal government has just launched a consultation process to consider the ramifications of this and other changes to pension legislation federally.

Some corporations who sponsor DB plans, as well as lenders and other financial institutions have raised concerns that such changing creditor priorities in insolvency could have serious unintended consequences including affecting a company's ability to raise capital. These concerns could be reduced or eliminated if robust GF coverage were in place as this would conserve available capital that could be used to pay high priority creditor obligations in insolvency.

It is true that the start-up of a GF model in B.C. would add regulatory costs, and will not provide assets for full coverage until the GF attains a sustainable size. Because there is such a large reduction in plan costs for GF premiums vs. solvency funding costs, the higher regulatory costs can readily be accommodated within GF premiums. CFP estimated, in its Ontario submission, that just 5% to 10% of the savings from the solvency funding relaxation that Ontario proposed (and subsequently adopted) would provide adequate funding for a sustainable, full-coverage GF. Most of the savings accrue to the plan sponsors. B.C. could avail itself of the experience of the Ontario pension regulator to further clarify our assertion of large "premium" reductions inherent in adopting CFP's GF model.

Concerning the time required to build up an adequate GF, the present rising-interest-rate circumstance is beneficial since plan deficits are significantly improved with even modest interest rate increases, lowering the call on a fledgling GF upon plan wind up. Any untoward coincidence of multiple calls on the growing GF could be dealt with via a bridge loan that could be repaid when a more-normal risk situation returns.

In the alternative, a transition period for introducing a GF could see solvency funding requirements relaxed over time on a defined schedule as the GF was built up. It would be possible to completely remove solvency *funding* requirements by the time the GF becomes sustainable. To be clear, there would still be a need to determine solvency *status* during pension plan valuations (as is now the case in Quebec) to inform the risk-based setting of GF premiums, and to allow regulatory oversight if plans were becoming financially troubled.

How does CFP's GF model meet the stated objectives of B.C.'s Review? It clearly deals fully with the Benefit Security objective.

The second Review objective includes Contribution Predictability, which is significantly enhanced by the large reduction in solvency funding required to cover group rather than self-insurance premiums. Premium variability is less of a concern when premiums are an order of magnitude smaller as with our proposed GF model. And the risk-based GF premium is more within the control of the sponsor in response to external financial/demographic changes. The other component of the second objective, Plan Sustainability, is also improved intrinsically because of the large premium reduction afforded by the group insurance paradigm.

The third Review objective, Pension Coverage, is likely to improve as other firms that don't now sponsor DB pension plans are informed of the reductions in plan funding requirements documented above.

The final Review objective, Balancing Stakeholder Interests, is also well met:

- Sponsoring employers see large solvency cost reductions
- Unions representing affected employees see full benefit security and better plan sustainability
- Active members are assured that their full benefit is covered by GF with reduced solvency funding required (this directly affects those whose plans require employee contributions)
- Retired and deferred members don't have to worry that their pension benefit might be reduced
- And governments (taxpayers) are not needed to backstop plans in financial difficulties

So in conclusion, CFP believes that its Guarantee Fund model leads to deep reductions in the funding required to insure against benefit reductions upon plan wind up while in deficit, by swapping solvency funding (self-insurance) for a group insurance design.

3.0. Comments on Specific Options for Reform Identified in the Consultation Paper, and the Potential Impact of CFP's Proposed GF Model

A. Modified Requirements for Solvency Funding

A1 Longer solvency deficit amortization period: This implicitly lengthens the period during which a solvency deficit persists, *decreasing* benefit security by increasing the likelihood of a deficit existing, and the magnitude of any such deficit, in the event of insolvency. CFP's GF model, on the other hand, fully secures the pension benefit, and at significantly reduced cost.

A2 Consolidation of solvency deficiencies: This means that the shortfall only approaches full funding asymptotically over a period much longer than the nominal amortization period. CFP's GF model avoids this by covering any shortfall completely, but only when required by the rare event of a wind up triggered by financial difficulties.

A3 Smoothing asset values: Smoothing does moderate volatility, but at the cost of obscuring the relationship to actual plan assets. In the event of insolvency the actual plan assets are what will determine the plan's ability to meet its obligations. As above, CFP's GF model avoids this risk.

A4 Average interest rate: Averaging rates would implicitly ignore the fact that when plans are wound up and annuities purchased, the current rate is the only one that applies. Use of an average rate could present a misleading view of plan "health" and the impact on benefits if the plan were wound up. CFP's GF model deals with benefit security at lower cost.

A5 Solvency funded to less than 100%: This would clearly and directly decrease benefit security, contrary to the Review's first objective. Of course, CFP's GF model does completely meet that objective. As indicated above in the full description of the GF model (see p.4), the maintenance of a 100% solvency funding target when such a model has been put in place becomes more of a balancing act between individual plan funding and the potential liabilities of the GF.

If after the present consultation, B.C. decides not to proceed with our GF model, then CFP strongly urges B.C. to retain robust pension funding requirements in the form of a 100% solvency funding target. This is a critical element that contributes to the security of workplace pensions in B.C. As described above, this doesn't guarantee that pensions will be fully funded at all times, but it provides the appropriate target.

In general, the current approach to solvency funding (under review in this consultation) does not fully secure DB pensions, because it fails to address the problem that in insolvency plans are forced to wind up under the specific conditions (e.g. asset values) that exist at the time of wind up, and the reality that those conditions can vary quickly and significantly. For this reason, options such as those commented on above, which can generally be described as “smoothing approaches” which do not represent real time conditions, risk further eroding benefit security, unlike CFP’s GF model (which also allows significant reductions to funding requirements).

B. Replacing Solvency Funding with Enhanced Going Concern Funding

B1 <u>Shorter going concern (GC) deficit amortization period</u>:

GC funding does not relate to the realities of the wind up scenario. A shorter GC amortization period does tend to improve benefit security, but not significantly and certainly not enough to offset a move from solvency to GC funding. CFP’s GF model directly covers the benefit security objective.

B2 <u>Funding Buffer (PfAD)</u>:

CFP support the concept of requiring pension plans to build up a Funding Buffer (Provision for Adverse Deviation). However this approach would be difficult to determine and implement and it is unlikely that this provision would be sufficient to support a move away from solvency funding.

Indeed, an argument can be made that the current solvency funding approach could better recognize the need for pension plans to be funded at higher than 100% at the top of a business cycle, if they are to avoid being significantly underfunded most of the time. In the past 15 years at least, average plan funding levels have been well below 100%. This comes about at least in part because when funding levels have been high regulators have allowed immediate “contribution holidays” to avoid a large overfunding, while when solvency funding Is low sponsors have been given a minimum of 5 years to make up deficits (under solvency funding rules) and at times extensions have been granted that have increased this time to 10 years or more.

This regulatory approach, which acted against over-funding, was in the past justified by the problem that sponsors had in establishing legal right to plan surpluses upon wind-up; however this has since been resolved.

From the perspective of plan sponsors, demands for a Funding Buffer or any similar requirement would, as the consultation paper explains, tend to tie up funds that a sponsor might want to use instead for normal business purposes.

Allowing companies to cover liabilities with Letters of Credit is a reasonable approach to addressing this concern.

In general, options for enhancing GC funding rules have an insufficient effect on protecting plan benefits in wind up to justify a move away from solvency funding. They don't deal directly with wind up situations, and tend to create new complications.

CFP's GF model is a simple, effective and low cost way of dealing with wind ups directly.

4.0 Other measures

Modifying Commuted Value (CV) Transfer Rules:

CFP is fully in agreement that such transfers tend to weaken a pension plan for remaining beneficiaries, especially in the present low interest rate environment. This can have a significant impact since companies will often terminate, or offer retirement packages or incentives, to large numbers of employees when they are in financial distress and moving closer to insolvency and potential wind up of their pension plans. CFP supports measures that would enforce the principle that commuted value transfer rules must not weaken the financial position of the plan, and that would hold companies liable for any extra costs this might entail.

CFP believes that an interest rate more reflective of the expected rate over the typical remaining life expectancy of active plan members would be fairer to remaining plan members. CFP doesn't have the expertise to define such a rate, but knows that the Canadian Institute of Actuaries (CIA) would be able to make that determination.

Options upon Plan Wind-up

The premise behind solvency funding (and CFP's GF model) is that the only way to deal with plan wind ups while in deficit is by buying annuities to provide payments equivalent to the pension promise after wind up. However, there is another ways of securing the pension promise—the pension plan of an insolvent company can have the plan's administration taken over by a government agency or by a large pension plan on a full cost basis, so that the plan continues to run as a going concern. This allows for recovery if external economic conditions improve. Also, plan costs are likely to be reduced because of the group administration aspect, and the improved access to investment opportunities for the plan's assets at lower fees. Quebec now allows this option, with a time limit if recovery doesn't occur. Consolidation of public pension plan administrations in Ontario also indicates the benefit of such an approach. Allowing this option could reduce the call on a Guarantee Fund with attendant lower required premiums.

A related step that could be taken easily and immediately in each pension jurisdiction would be to give all pension plan members the right to accept options other than annuities in the event their pension plan is wound up. More specifically, individuals could be allowed to transfer (to the extent allowed by the CRA) those funds attributable to them to their own RRSPs/RRIFs or other such vehicles. This would allow them an opportunity to invest this money themselves rather than accept (possibly reduced) pensions based on annuities. Members of some Canadian pension plans have been able to negotiate this right or have obtained it through court action. While some have opposed this happening on the grounds that pensioners require the security of annuities, pension advocates including CFP reject that argument as paternalistic and inconsistent with the fact that Canadians already are expected to take responsibility for much of their own retirement finances through RRSPs, TFSAs and other vehicles.

Annuitization of active plans

Some corporations have chosen to cover or are considering covering their on-going pension plan liabilities by purchasing annuities, a de-risking plan. Considering that insurance companies supplying those annuities have a robust backstop against default through Assuris, there is no significant risk to pension benefits in this process. Therefore, B.C. should consider a statutory discharge from liabilities covered by annuities for pension plans that partially secure pension benefits in this way.

5. Conclusion

CFP's firm and considered position is that dealing with pension benefit security through the options the consultation paper suggests, or similar "tweaks" to the current approach, will always be inadequate. In contrast, CFP's Guarantee Fund proposal directly and completely provides full security for pension plan members at modest cost compared to continuing with solvency funding or implementing equivalent approaches (i.e. self-insuring against deficits upon wind up by each individual plan).

CFP trusts that the B.C. Ministry of Finance will give due consideration to our proposal for the benefit of plan beneficiaries, plan sponsors and, indirectly but significantly, the province's social safety net when pension plans are forced to wind up while underfunded. CFP remains available to further explain and discuss our proposal, that will benefit British Columbia-regulated pension plan sponsors and beneficiaries.