

Submission to
The Ministry of Finance

Responding to the
Report of the Expert Commission on Pensions

by the
Ontario Federation of Labour
February 2009

Introduction

The Ontario Federation of Labour (OFL) represents over 700,000 workers who belong to 1,500 affiliated local unions in Ontario. Our members work in hundreds of occupations -- from government employees to construction workers; from nurses to industrial mechanics.

The OFL is the collective voice of union members on issues relevant to working people – from labour relations to health care to economic policy.

On behalf of our members, the OFL is pleased to be providing this response to the Report of the Expert Commission on Pensions.

We look forward to working with the Ministry of Finance to implement the Arthurs Report recommendations expeditiously.

New Context

The context for any discussion of pension law reform has changed dramatically since the Expert Commission was established, and even since the report was written. The severe economic downturn was precipitated by the crisis in financial markets that resulted from a failure of financial market regulation. Trust in financial markets and financial managers, so crucial to the pension promise, has been injured. Governments have failed to provide sufficient regulatory oversight and protection to the retirement savings of their citizens.

Asset values have dropped dramatically. Many workers are unemployed or facing unemployment. Many plan sponsors are facing financial difficulties. Governments have responded to the financial market crisis with aggressive interest rate reductions. All these events have a negative impact on Ontarians' retirement savings whatever form that they take: defined benefit pension plans, defined contribution pension plans, and private savings for retirement.

Investment losses in combination with falling interest rates have ravaged the balance sheets of defined benefit pension plans. Watson Wyatt estimates that the funded ratio of defined benefit pension plans plunged from 96 percent at the beginning of 2008 to 69 percent at the end of the last year.¹ Mercer's found similar results, with their Pension Health Index funded ratio fell to 59 percent down from 82 percent at the beginning of the year.²

Given the long-term nature of the pension promise, in different economic circumstances, a deterioration of defined benefit pension plans' balance sheets could be a passing problem. However, many private-sector plan sponsors are in financial trouble, and increased contribution requirements could threaten their continued operation. Increased contributions could have a negative impact on the services provided by public-sector pension plan sponsors facing fiscal difficulties and increasing demands for their services due to difficult times. It is likely that a number of private-sector pension plans will be wound up in this

underfunded state due to bankruptcy of plan sponsors. Should this be the case, both active plan members and retirees could see a reduction in their benefits.

For defined contribution (DC) pension plan members, the difficulties may be less complex, but the consequences for retirement security are disastrous. The value of plan members' retirement savings has been sharply reduced. A plan member who has an often recommended asset allocation of 70 percent equities and 30 percent fixed income would see savings drop by 28 percent. Unlike members of defined-benefit single employer pension plans (SEPPs), DC employer sponsors have no legal responsibility to make up for the loss in value of plan members' savings. Unlike members of multi-employer pension plans (MEPPs), DC plan members are unable to spread this risk over a large number of plan members, or over time.

This grave situation highlights the importance of the government's task in pension reform. The lessons from this crisis should not be lost: first, the important role of government regulation and oversight to protect the pension promise. Second, the pressing need to improve pension plan coverage for Ontarians.

Sixty-two percent of Ontarians have no pension plan, and have to save on their own for retirement. The Commission's Report and research outlines who these Ontarians are:

- They are not likely to be members of a union. While 76 percent of unionized workers are active members of occupational pension plans, only 28 percent of non-union workers are members of pension plans.³
- They are more likely to work in a small workplace. About 60 percent of workers in workplaces with more than 1,000 employees have pension plans; 10 percent of workers in workplaces with less than 20 employees are members of pension plans.⁴
- They are more likely to be racialized and immigrants. Even after 10 years in Canada, pension plan membership numbers for female immigrants are lower than for Canadian-born female workers. Pension coverage has remained lower among racialized group men than among other immigrant men.⁵
- They are more likely to be working in part-time, seasonal, or contract jobs.⁶

Responses to Recommendations on Expanding Pension Plan Coverage

The Commission's Report painted a clear picture of the limitations of the current occupational pension system in Ontario. It shows:

- the declining numbers of private-sector workers who are members of pension plans;
- the threats to benefit security associated with single employer pension plans and their potential for failure;
- the threats to benefit security in defined contribution pension plans because risk is not shared across plan members; and
- the need for increased portability of pension benefits in a labour market where an individual is likely to change jobs many times over their working life.

It also outlined the benefits associated with large pension plans:

- reduced administrative costs and financial management costs which can have a very large impact on pensions (the Report illustrated that over 40 years higher fees associated with small plans can reduce pensions by up to 60 per cent);
- it outlined the benefits associated with risk sharing across population groups and across different age groups;
- it described the greater flexibility in investment vehicles available to larger plans; and
- finally, it described the increased security and stability associated with larger pension plans.

Recommendation 9-2

Pension policy and legislation ought to facilitate the growth and operation of large-scale pension plans or to enable and encourage cooperation among small- and medium-sized plans.

Recommendation 9-3

Legislation and regulations should be enacted to enable and promote large commingled target benefit plans that might provide affordable pension coverage to Ontarians who do not presently have pensions or for whom the costs of obtaining a pension are unnecessarily high.

Recommendation 9-4

The government of Ontario should investigate the advantages and disadvantages of expanding the mandate of the Canada Pension Plan, or creating a comparable provincial plan, so as to enhance pension coverage, control costs and improve benefit portability.

Recommendation 5-2

The Lieutenant Governor in Council should establish an Ontario Pension Agency to receive, pool, administer, invest and disperse stranded pensions in an efficient manner.

The results of the Commission's research and recommendations clearly points to the need for increased pension security for Ontarians. The most effective way to do so would be an increase in the benefit levels of the Canada Pension Plan. This would draw on existing economies of scale, risk-sharing, and administrative efficiencies of the plan. We believe that the likelihood of such an expansion is higher now than in the recent past. The recommendations for expanded role for government in pension coverage in the recent Nova Scotia⁷ and British Columbia⁸ expert reviews make the required agreement more likely to occur.

We therefore support Recommendation 9-4. Further, we recommend that Ontario initiate negotiations with other Governments in Canada to increase CPP benefits. However, pension reform cannot wait indefinitely. If material progress is not made in these negotiations within six months, Ontario should move ahead on its own to develop an employment-based CPP-like plan.

We support Recommendation 5-2, establishing an Ontario Pension Authority. We believe that pooling, administering, investing and dispersing stranded pensions would be an important role for the authority. However, we believe that the OPA can also have an important role in implementing the policy objectives in Recommendations 9-2 and 9-3. We recommend that the government provide for an expanded role for the OPA in providing investment services and pension plan administration to smaller plans. Should negotiations with other governments prove unsuccessful, the Authority should be the administrator of the Ontario-based plan. To reduce costs, and enhance benefit levels, the OPA should be in the public sector to ensure its non-profit status and avoid high management fees.

Benefit Security and Plan Administration

The labour movement believes that, with respect to issues of benefit security, plan financing and oversight, the Report has achieved overall a balance of interests. However, we would caution the Government against a piecemeal implementation. Our responses to specific recommendations follow.

Recommendations on Different Funding Requirements for Different Types of Plans

Recommendation 4-9

Following consultations with Ontario's multi-employer pension plans, special legislation and regulation should be developed relating to all aspects of their funding, regulation and governance. The basis for such legislation and regulations should be the Specified Multi-employer Pension Plan regulation of 2007. After five years, the practical effects of these arrangements should be assessed.

Recommendation 4-10

Multi-employer pension plans should be required to fund only according to going concern valuations, but should continue to provide solvency valuations for the information of the regulator as well as their active and retired members.

Recommendation 4-11

Jointly sponsored pension plans should be required to fund only according to going concern valuations on the same basis as the Specified Ontario Multi-employer Pensions Plans, but should continue to provide solvency valuations for the information of the regulator as well as their active and retired members. The comprehensive legislation and regulations governing the funding of multi-employer pension plans, to be developed pursuant to Recommendation 4-9, should apply, perhaps with appropriate modifications, to jointly sponsored pension plans.

We support the Expert Commission's recommendations. We believe that these recommendations balance the needs for benefit security for members, while taking into account the differences in structures and risks faced by members in different types of pension plans. Shortening the amortization period for going concern deficiencies to between 8 and 12 years rather than 15 years will enhance benefit security. The continued requirement for solvency valuations will provide important information to trustees, trade unions and plan sponsors about the financial health of the plan. These measures will provide balance to the recommendation to eliminate solvency funding requirements.

Recommendations on Surplus Distribution

Surplus Distribution on Plan Wind-Up

Recommendation 4-16

If a single employer pension plan is in surplus on being wound up, the surplus should be distributed in accordance with the plan documents unless the parties agree, or the proposed Pension Tribunal of Ontario rules that the documents are not clear. In the event of such an acknowledgement or ruling, the sponsor may propose a scheme for the distribution of surplus, which would take effect if approved in one of two ways:

- (a) if plan members are not represented by a union, the proposal should be submitted to a vote by secret ballot of the plan members and retirees, and would take effect if approved by two-thirds of those voting; or
- (b) if plan members are represented by a union or other organization, the sponsor should submit its proposal to representatives of the active members and retirees with a view to concluding a surplus distribution agreement.

If the sponsor and the representative negotiators cannot reach agreement, they should submit the matter for determination to a dispute resolution procedure of their own choosing. If they cannot agree on such a procedure, or if it does not resolve the matter within a reasonable time, any party may apply to the Superintendent to refer the matter to the Pension Tribunal of Ontario, which would then establish the terms of the surplus distribution agreement.

Any scheme approved by secret ballot, any surplus distribution agreement reached by representative negotiators, and any determination by the Tribunal or an agreed dispute resolution procedure would be final and binding on the Superintendent and on all persons claiming to be entitled.

Recommendation 4-16 represents a significant loss of entitlement for plan members from the current mandatory surplus sharing regime. A number of recommendations are relevant to our response to this recommendation. If Recommendations 6-17, 5-8, and 5-11 were implemented, we would not oppose Recommendation 4-16.

Surplus Distribution from Ongoing Plans

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 4-18 would allow easier access to plan surplus in an ongoing plan by reducing the threshold of approval required from 100 percent down to two thirds. Recent experience in financial markets, which resulted in sudden deterioration of funded status of plans, suggests that easing requirement for surplus withdrawals from ongoing plans is inadvisable. We therefore oppose this recommendation.

Surplus Distribution on Partial Wind-Up

Recommendation 5-12

Active plan members who are involuntarily terminated, whether in groups or individually, while a plan is ongoing should not be entitled to an immediate distribution of surplus. However, those who leave their pension assets in the plan should retain the right to participate in any subsequent surplus distribution.

In eliminating access to plan surplus on plan wind-up, this recommendation represents a significant loss of entitlements for plan members. A number of recommendations are relevant to our response to this recommendation on partial wind-up. If Recommendations 6-17, 5-8, and 5-11 were implemented, we would not oppose Recommendation 5-12.

Recommendation 6-17

The level of monthly pension benefits eligible for protection by the Pension Benefits Guarantee Fund should be increased to a maximum of \$2,500 to reflect the effect of inflation on the original maximum of \$1,000.

The Superintendent (or other agency responsible for the administration of the Pension Benefits Guarantee Fund) should recommend to the Minister of Finance within one year:

- the formula by which benefit levels should be determined on a going-forward basis;
- the basis on which the levy paid by sponsors should be calculated;

- procedures for ensuring that both the benefits and the levy are adjusted at regular intervals; and
- any other matter relevant to the implementation of this recommendation.

The recommendations should be accompanied by a statement concerning the anticipated effects of any such adjustment. The Minister should act promptly upon receipt of these recommendations and the accompanying statement.

This recommendation is key to the benefit security of Ontario plan members, and is especially so given the proposed weakening of solvency funding rules during this period of economic crisis. We therefore strongly support Recommendation 6-17 to update the maximum benefit coverage of the Pension Benefit Guarantee Fund, and urge that the implementation of this recommendation proceed as quickly as possible. We are prepared to participate, along with other unions, in the process of analyzing and improving the administration and funding of the PGBF, as the Commission recommends.

Recommendation 5-8

Existing “grow-in” rights that provide access to early retirement benefits for all qualifying single-employer pension plan members in the event of a full or partial plan wind-up should be extended to all such members who are involuntarily terminated. “Qualifying members” should continue to be those whose age and years of service add up to 55.

We strongly support this recommendation. We believe that it would increase equity and reduce the number of disputes about full or partial wind-ups. However, limiting the grow-in to “involuntary quits” is highly problematic. It is frequently unclear whether termination is voluntary. Pension legislation does not generally differentiate between voluntary and involuntary terminations, and is not an issue in which the Regulator has any special competence. Attempting to differentiate between voluntary and involuntary quits add to cost, complexity and inequity. The “grow-in” provision must not be limited in this way.

Recommendation 5-11

All active plan members should be immediately vested for all accrued pension benefits. However, as at present, the plan administrator should retain the discretion to authorize the payment out of small amounts in specified circumstances.

We strongly support this recommendation.

Surplus Distribution on Plan Splits, Mergers and Conversions

Recommendation 5-17

Any surplus in a plan that is to be split (the “original plan”) can be allocated to any of the new plans derived from it, provided that the liabilities associated with the original plan and all of the derivative plans remain fully funded (including the 5% security margin) as of the date of completion of the transaction.

Recommendation 5-18

Any surplus in a plan that is to be merged with another plan can be assigned to the merged plan, provided that the members of the original plan remain in the new merged plan, and that the merged plan itself is fully funded (including the 5% security margin) as of the date of completion of the transaction.

Recommendation 5-19

A sponsor considering a plan split or merger must give notice of the proposed transaction to active plan members and retirees, and any union or other organization representing them. The notice should be accompanied by an accurate, readily understood explanation of its implications, as well as technical data relating to the new plan in a form approved by the regulator.

If the union or representative organization approves of the proposed transaction or, in the absence of such an organization, if the transaction is approved by two-thirds of the active members and retirees voting in a secret ballot, the approval shall be filed with the regulator. Upon receiving the approval and ensuring that the transaction is otherwise in accordance with Recommendations 5-17 and 5-18, the regulator may, without further delay, issue an advance ruling approving the transaction.

In the absence of approval from the union, organization or plan beneficiaries, the sponsor must give 90 days’ notice to all interested parties and to the regulator. After expiry of the 90 day notice, the regulator should process the proposed transaction in the normal manner.

Where a split or merger is proposed by any plan on whose governing body at least 50% of the members are nominated by active plan members and/or retirees, approval by that governing body should serve in lieu of the approval process set out in this recommendation.

Recommendation 5-20

Notwithstanding Recommendations 5-18 and 5-19, a sponsor may, with the consent of the Superintendent, use surplus from the original plan to fund a new plan into which it has been merged, or from which it is derived, provided that (a) if the original plan continues in force, its security margin is maintained; (b) the new plan is funded at not less than 100% from its inception by sponsor contributions, if necessary; and (c) the security margin in the new plan is funded within five years.

Recommendation 5-21

Following conversion from a defined benefit to a defined contribution plan, or to a hybrid plan with elements of both, surplus carried over from the original plan should first be used to provide the required security margin for defined benefits earned under either plan. If additional surplus remains, it should be available to fund contribution holidays or other expenses of the converted plan.

These recommendations are problematic if they are implemented in a way that allows employers to avoid the normal rules applicable to surpluses. The recommendations provide only the opportunity for a 90 day delay if plan members or unions do not agree to the use of surplus in a merger or plan split. Such a consultative requirement is particularly troublesome in Recommendation 5-21 that provides for surplus use in conversions from defined benefit plans to defined contribution plans. Plan mergers, splits, and conversions should not be opportunities for employers to appropriate surpluses or apply them to their own obligations. Defined benefit surpluses should not be used to subsidize conversions to defined contribution plans. The windfalls that accrue to plan sponsors in this kind of conversion should be sufficient, without providing access to surplus from the wound up plan as well.

We are particularly concerned about the potential for manipulative asset transfers from plans in which employers have surplus entitlements to plans whose language purports to give the employer exclusive surplus entitlement.

We believe that member and beneficiary agreement, as outlined in Recommendation 4-16, should be required before surplus is transferred in splits and mergers.

Recommendations on Plan Governance

Recommendation 8-19

The regulator should make available on-line to active and retired plan members and their authorized representatives – without charge but subject to security arrangements – all plan documents as well as triennial, annual or other valuations and reports required to be filed with the regulator.

Recommendation 8-21

Plan administrators should provide an annual information statement to active and retired plan members in easily understood language or languages. The statement should include:

- a simple description of how pensions are funded and benefits are calculated under the plan;
- information on the plan's funded status (including whether it is in surplus or deficit and whether a contribution holiday is in progress or contemplated);
- the potential impact of its funded status on active and retired members' pensions; and
- a telephone number and/or website address where further information can be obtained from the administrator or the sponsor and similar coordinates for the pension regulator.

We support these requirements for disclosure to plan members and their representatives.

Recommendations on Funding

Recommendation 4-17

Plan sponsors should be entitled to reduce or omit their contributions to a plan in any year in which it is funded at 105% or more of its solvency liabilities. However if – based on benchmarks to be developed by the regulator – a plan administrator knows, or ought reasonably to know, that funding has fallen below 95%, the administrator should immediately notify the sponsor to resume contributions until the plan is again funded at 105% of insolvency liabilities. The pension regulator should develop benchmarks based on the plan's annual financial statements that will enable plan administrators to determine when contributions should be resumed.

If the regulator finds that a contribution holiday was improperly taken or continued, any contributions withheld from the plan should become immediately due and payable, together with interest, regardless of the plan's present funded status, and the sponsor should be subject to an administrative fine of up to \$1 million, or double the amount withheld during the improper contribution holiday, whichever is less. The improper use of plan surplus to pay the expenses of the plan, including PBGF premiums, should be treated in similar fashion.

The parties to a collective agreement should be free to negotiate other arrangements for the use of surplus in an ongoing plan. These arrangements should prevail notwithstanding those proposed in this recommendation or established in the plan documents.

We have concerns about this recommendation. The lesson from the last few months is that any contribution holidays should be approached with much caution. If the parties to a collective agreement have not negotiated an arrangement with respect to contribution holidays, we believe that plan sponsors should be required to obtain agreement from plan members. The way in which an agreement is reached should be the same as the method outlined in Recommendation 4-16.

Recommendation 4-3

Going concern valuations should no longer permit the exclusion of promised indexation benefits. Solvency valuations should no longer permit the use of smoothing practices or the exclusion of benefits. A special exception should be made for those plans that continue to provide plant closure benefits pursuant to a specific, longstanding commitment to continue their non-funded status.

Potential increases in sponsor contributions attributable to these enhanced transparency measures should be offset so far as possible by the extension of amortization periods, by selective relief from contribution increases for well-funded plans or by other means.

We are concerned about the impact of these recommendations on costs. Instead of eliminating smoothing altogether, we would recommend clear limitations to prevent smoothing from providing an asset value significantly greater than the market value.

Other Recommendations

Recommendation 5-14

Partial wind-ups of single employer plans should be declared by the Superintendent only when 40% of the active members of the employer are terminated within a two-year period. In such circumstances, administrators should file a plan reduction report, which would enable the Superintendent to ensure that plan funding is secure.

If Recommendations 6-17, 5-8, 5-11 and 5-12 are implemented, we would not oppose implementation of this recommendation. However, if they are not implemented, we are concerned that this recommendation imposes a much higher threshold for partial wind-ups than have been established by recent Financial Services Tribunal decisions.

Recommendation 5-10

The *Pension Benefits Act* should be amended to provide for phased retirement as contemplated by the *Income Tax Act*

The labour movement has serious concerns about the impact of phased retirement on older workers and on collective bargaining relationships. At minimum, we would recommend the following conditions on phased retirement: it should be a benefit available to all plan members; it should have a fixed duration of no more than 36 months; and, it must be tied to the member having a reduction in hours worked.

Recommendation 6-4

When a pension plan has been identified as “at risk,” the Superintendent should have power to approve the arrangements identified in Recommendations 6-2 and 6-3, conditional upon the suspension or cancellation of any agreement to improve plan benefits, and/or a prohibition on plan benefit improvements, until funding is restored to a specified level.

Recommendation 6-5

When a plan fails and is being wound up, payments attributable to benefit improvements initiated up to five years prior to the date of the wind-up should be paid only after all pre-existing benefits are paid in full.

Recommendation 6-9

Plan assets should be distributed on a pro rata basis. However, benefit improvements introduced within the last five years should be postponed until after other benefits are paid, in accordance with Recommendation 6-5, above.

We are concerned about the impact this group of recommendations could have on bargaining relationships and benefit security; in particular, for members of flat benefit pension plans. Recommendation 6-4 provides blanket powers to the Superintendent to cancel or suspend improvements that have been bargained. Any such improvements would be the result of a number of complex trade-offs in total compensation. These powers are too extensive.

Recommendation 6-5 refers to plan failures. This recommendation, if implemented, should only apply to bankrupt plan sponsors, and should only apply to the benefits increases introduced within the last 3 years.

Recommendation 5-4

When individual or group transfers from one plan to another are contemplated, the importing plan should provide a detailed statement of the benefits to be provided. Each transferee should be given four options:

1. as a default option, to accept the asset transfer and begin future accruals in the importing plan, provided it offers benefits of comparable aggregate value to those provided under the exporting plan;
2. to remain as a deferred member of the exporting plan;
3. to transfer the value of the first pension to the Ontario Pension Agency; or
4. to transfer the value to a locked-in account.

If active plan members are represented by a union or similar organization, it may accept one option on behalf of all members, or allow each member to exercise one or more of the options provided.

The value of benefits provided by an “importing” plan should be deemed to be “comparable” to those provided by an “exporting” plan for purposes of the default option, if (a) approved by the Superintendent as approximating the aggregate collective value of such benefits, notwithstanding differences in the nature, value or

terms of individual benefits, or (b) agreed to by a union representing active plan members affected by the transfer.

Recommendation 5-5

The government should promptly address the pension arrangements for groups of public service employees affected by past divestments and transfers, whether by allowing these groups to use the group asset transfer process proposed in Recommendation 5-4, or by other means, including negotiations with their representatives.

We support the greater emphasis on union negotiations on asset transfers as well as the provision of more pension options for workers about to be divested.

Recommendation 8-23

Plan statements of investment policy should reveal whether, and if so, how, socially responsible investment practices are reflected in the plan's approach to investment decisions.

We support this recommendation.

Conclusion

We appreciate the opportunity to provide input on this important area of public policy. We look forward to working closely with the Ministry and other stakeholders on implementation of the Report's recommendations.

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- ¹ Watson Wyatt (2009, January 8). The Solvency of Canadian Pension Plans Plummet in 2008, Watson Wyatt's Pension Barometer Finds.
 - ² Mercers. (2009). Canadian Pension Plans Pummelled in 2008. Retrieved on February 3, 2009 from <http://www.mercer.ca/referencecontent.htm?idContent=1332340>
 - ³ Ontario Expert Commission on Pensions. (2008). A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules. *Toronto: Queen's Printer for Ontario*, p.39
 - ⁴ A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules, p.39
 - ⁵ A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules, p.47
 - ⁶ A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules, p.45
 - ⁷ Nova Scotia Pension Review Panel (2009, January 27). Promises to Keep. Retrieved February 26, 2009 from <http://www.gov.ns.ca/lwd/pensionreview/docs/PensionReviewPanelFinal.pdf>
 - ⁸ Joint Expert Panel on Pension Standards (2008). Getting our Acts Together: Pension Reform in Alberta and British Columbia. Retrieved February 26, 2009 from http://www.ab-bc-pensionreview.ca/2008_1125_jepss_final_report.pdf