

Alberta/British Columbia Pension Standards Review

Joint Expert Panel

INTRODUCTION

On October 19, 2007 the governments of Alberta and British Columbia announced the appointment of a Joint Expert Panel on Pension Standards (the Panel). This panel was charged with reviewing two pieces of legislation: the Alberta *Employment Pension Plans Act* (EPPA) and the British Columbia *Pension Benefits Standards Act* (PBSA). As part of this review, the Panel has asked for submissions from interested individuals and organization. The Alberta Federation of Labour (the AFL) is pleased to have this opportunity to respond to the Panel, and to its discussion paper, *A Better Pension System for the Future: Finding a Balance*.

This “balance” will be the focus of the AFL’s submission. In recent years employment pension plans, and Defined Benefit (DB) plans in particular, have been the subject of significant debate in the field of industrial relations, in the business media, and in the larger public policy sphere. Some participants in this debate have gone so far as to question the continued viability and desirability of workplace DB pensions. In some contributions to this debate, repetition and volume have substituted for balanced, fact-based analysis. We hope that our submission and the Panel’s report will, in fact, help to restore balance to the discussion.

We believe that in the Panel’s deliberations four points should be borne in mind. **First: the preservation and improvement of our retirement income system is one of the most critical public policy issues of our time.** The demographic realities noted in the Panel’s discussion paper – the aging of the “baby boomer” cohort and the increasing life expectancy of retirees – mean that the health of our public and occupational pension systems is more vital than at any time in the last four decades. Failure to “get it right” will consign millions of Canadians to a life of poverty. The economic and social costs to the country would be catastrophic. In its brief to the Ontario Expert Commission on Pensions, the Canadian Labour Congress outlined the dimensions of this issue:

As of September 2005, most Canadians owe more than they earn. Canada, like the US, is now in the grip of a negative national savings rate, approaching 114% of earnings. If this trend is allowed to worsen, millions will retire into poverty (if they can afford to retire at all).¹

Second: current trends in pensions are worrying, and Canada faces a looming crisis in pension coverage. A recent study by Statistics Canada noted that:

Since the late 1970s, the proportion of employees covered by a registered pension plan (RPP) has dropped... – the decline in coverage by defined-benefit RPPs more than offsetting growth in coverage by defined-contribution plans.²

¹ Canadian Labour Congress, “Move Forward Together or Fend for Yourself? The Future of Ontario’s DB Pension System,” Submission to the Ontario Expert Commission on Pensions, 2007, p. 12.

² René Morissette and Yuri Ostrovsky, “Pensions and retirement savings of families,” Statistics Canada, *Perspectives on Labour and Income*, Winter 2007, p. 43.

Reversing these two trends – the overall decline in RPPs and the shift from DB plans to lower-quality DC plans – should be the goal of any recommendations resulting from this Review.

Third: even more than other laws, pension legislation should be formulated with a view to the long run. In the aftermath of the decline in equity markets between 2000 and 2002, much was made of the so-called “perfect storm” (poor returns on equities, low interest rates, and unfavorable demographics) confronting the pension system. With the current uncertainty in real estate and international financial markets, a similar outcry can be expected. The Panel should regard such arguments with skepticism. Economic booms and busts have been a feature of the free market capitalist system for almost two centuries; they are part and parcel of the business cycle. It is axiomatic that any proper retirement savings system (and this applies to defined benefit pension plans in particular) must look beyond the periodic ups and downs of the markets. The same is true of pension legislation: it shouldn’t be formulated in response to short-term trends in the economic or political environment.

Fourth: employers and employees view pension plans from very different perspectives. As the Panel’s discussion paper noted,³ for some employers pensions are simply part of the total compensation package, and should be configured to conform with the company’s human resources strategy. Over the last two decades, other employers have begun to use pension funds as financial tools to improve corporate profits:

The pension accounting requirements of the Canadian Institute of Chartered Accountants have been in effect since 1987. From that time and through 1999, pension funds delivered ‘profit’ to corporate financials as surpluses measured in accordance with accounting principles grew in value. Consequently, a view developed that DB pension plans provided added benefit to companies as ‘cash flow management tools,’ with benefits primarily realized via ‘contribution holidays’.⁴

This kind of thinking underlies several positions advanced by employers in the discussion of pensions issues such as access to surplus, “risk asymmetry,” and the “irritant” of legislative requirements for disclosure.

Needless to say, unions do not share this view. We insist that pensions are deferred wages, held in trust for the benefit of employees. So far, at least, the courts have tended to share this perspective. The Panel should do likewise.

THE HISTORICAL CONTEXT

The roots of the current “crisis” stretch back more than two decades. In the 1980s, faced with lagging profitability and increased competition, some businesses began to view pension funds as a source of cash. With equity markets producing strong returns, employers were able to fund

³ A Better Pension System for the Future: Finding a Balance, p. 6

⁴ Greg Hurst, “Lies, Damn Lies, And Canada’s Private Pensions Funding Crisis,” *Benefit and Pensions Monitor*, February 2006, p.34

plans without having to make actual contributions, and access plan surpluses through contribution holidays.

This process was rendered easier by the fact that private sector employers could, within limits, influence the actuarial assumptions that were used to determine the funded status of the plan. Overly optimistic scenarios, based on the assumption that the then current high interest rates and high equity returns would continue into the foreseeable future, undermined the funding of the plans, and when interest rates and equity markets returned to historic norms, the funding “crisis” in DB pension plans was born.

There were, to be sure, other factors that contributed to the pressure on defined benefit pensions: the maturation of pension plans, firms and industries created challenges, and a decline in union density meant that DB plans lost powerful advocates. Indeed, the Statistics Canada study cited above examined the decline in RPP coverage in Canada between 1986 and 1997 and concluded that:

The numbers strongly support the notion that de-unionization tended to reduce RPP coverage.

and that:

...evidence strongly suggests that both de-unionization and employment shifts toward low-coverage sectors played important roles.⁵

It is nonetheless crucial that, when discussing issues such as the affordability of DB pension plans and access to surplus, we bear in mind the fact that it was employers accessing surplus that created the funding problems in many defined benefit pensions.

RECOMMENDATIONS

Occupational Pensions Plans in the Canadian Economy

It is a truism that pension plans can perform a recruitment and retention function in a competitive labour market. It is also evident that pension funds promote economic efficiency by pooling risk and providing an important source of investment capital.⁶ From an economic perspective, these are both sound reasons for supporting and extending pension coverage in Alberta and British Columbia. It does not follow, however, that these are the primary goals of our pension system, nor that economic competitiveness should provide a rationale for changes to our pension standards. The fundamental purpose of both public and occupational pension plans is the provision of a retirement income for workers – one that allows pensioners to live with dignity in their retirement years.

⁵ Morissette and Ostrovsky, Op. cit.

⁶ See, for example: Former Bank of Canada Governor David Dodge’s remarks to l’Association des MBA du Quebec, November 9, 2005.

The AFL is therefore opposed to any changes to public pensions or to the regulatory standards governing occupational pensions that are premised on expanding pension coverage by decreasing benefits.

Pensions Standards Legislation – Past, Present and Future

In the case of public pensions (the Canada Pension Plan and Old Age Security) for example, raising the retirement age would be a serious policy error. The problems of labour shortages and sluggish productivity won't be solved by using decreased pension benefits to coerce older Canadians back into the workforce.

On the contrary, public pension coverage should be expanded. The panel should urge the governments of Alberta and British Columbia to meet with the Government of Canada and other provincial governments to explore ways in which this could be accomplished. Since it is axiomatic that larger pension plans can reap significant cost advantages through economies of scale and improved risk pooling, expanded public pensions are the most cost-efficient vehicles for improving retirement benefits.

Broad Pension Policy Issues

The Panel's discussion paper includes a useful outline of the problems created by the existing patchwork of provincial and federal pension standards. The rationale for the harmonization of Alberta and B.C. standards, on the other hand, is sketchy. It isn't clear how significant the effect of such a measure would be in terms of efficiency and cost savings. What is clear is that the merit of such harmonization from the perspective of working people would depend entirely on the specific content of the harmonized standards – the devil is truly in the details.

From the perspective of the AFL, it makes far more sense to pursue “a single statute of national application, with a single regulator”. This parallels the repeated calls from the investment community for a single national securities regulator, a proposal which has thus far foundered on the rocks of provincial/federal jurisdictional disputes. It nonetheless makes sense in terms of efficacy and cost-effectiveness for both the pension industry and the regulators. It also reflects the reality that workers and jobs move around, and that occupational pensions routinely span different jurisdictions. The Panel should urge the governments of Alberta and British Columbia to abandon jurisdictional quibbling and meet with the federal and provincial governments to establish a single national regulatory regime.

The discussion paper also raises the question of whether pension standards should be “principles-based” or “rules-based”. In our view this closely parallels the shift in occupational health and safety legislation from “performance-based” to “prescriptive” standards, a trend that has, in the opinion of most union health and safety specialists, created serious problems. We believe that principles-based standards will, in the end, amount to low standards unevenly enforced. This is all the more likely in a regulatory environment that is, as the discussion paper points out, already fragmented. We doubt that the regulators currently have either the capacity or the authority necessary to provide the level of oversight required in such an environment, and we see no benefit attached to further moves toward a principles-based regime.

Specific Elements of the Standards

The AFL is also opposed to any regulatory change that would make it easier for employers to access plan surplus. The rationales advanced in support of such measures, in particular the so-called “risk asymmetry” argument, are unconvincing. The Supreme Court of Canada addressed this issue in the Monsanto decision, and concluded:

Employers often argue that the risk and responsibility of a defined benefit plan are borne by the employer and, thus, it should be allowed the control and flexibility to manage the plan as it sees fit. It is contended that requiring distribution of surplus weighs the balance too heavily in favour of the employees and will result in funds being contributed to according to less cautious actuarial estimates, fewer defined benefit plans, and fewer private pension plans overall. While important considerations, these arguments are unpersuasive.⁷ (emphasis added)

The Supreme Court noted that employers don’t offer DB pension plans out of disinterested benevolence – that “the provision of pensions serves a number of labour market functions which benefit the corporate sector.” The decision also observed that the regulatory scheme in place is designed to prevent the underfunding of pension plans by requiring the adoption of accepted actuarial practice.

The AFL offers one further point regarding the “risk asymmetry argument”: in private sector pension plans employers already have significant control over the main variables affecting their risk exposure⁸.

In the first place, of course, plan design is subject to employer approval, if not employer control. Even after the plan is in place, however, employers typically control or strongly influence investment policy and, within limits, actuarial assumptions. In the case of investment policy, the arguments made to the Supreme Court explicitly contemplated employers deliberately assuming higher risk in the hopes that higher returns would allow them to take contribution holidays. We submit that it should not be necessary to create regulatory incentives to prevent this kind of egregious misconduct on the part of employers. Employer influence over actuarial assumptions is also a concern, although this influence is clearly limited by the supervision of the plan actuary. Even a small adjustment to these assumptions, however can have a powerful effect:

*A one per cent reduction in the discount rate assumption results in a 15 per cent to 20 per cent increase in actuarial liabilities.*⁹

If anything, the AFL would argue that employers, using the above mechanisms, already have too easy access to plan surpluses. In fact, they can create plan surpluses, through a combination of risky investments and optimistic actuarial assumptions, then appropriate this actuarial surplus

⁷ Monsanto Canada Inc. v. Superintendent of Financial Services and Association of Canadian Pension Management v. Superintendent of Financial Services, (2004) 3 S.C.R. 152, 2004 SCC 54, p.14.

⁸ The following remarks do not apply to the Multi-Employer Pension Plans in the construction industry.

⁹ Hurst, *op. cit.*, p. 33.

through contribution holidays mandated by the *Income Tax Act*. As Greg Hurst notes, this kind of conduct represents an attempt to “game” the pension and tax systems:

However, viewing DB pension plans as cash flow management tools runs contrary to the purposes for which tax incentives to fund pensions are provided, and it conflicts directly with the employer’s fiduciary duties to the pension plan. Unfortunately, this view has a strong hold on actuaries and corporate finance professionals and lies at the heart of the ‘asymmetry’ arguments that plan sponsors unfairly bear all the risks of pension funding.¹⁰

The AFL believes that any regulatory change regarding access to surplus should be aimed at restricting the above kinds of activities. We propose a two-pronged approach.

First, the Panel should examine the possibility of raising standards for actuaries by:

1. Requiring a division of actuarial functions, separating the valuation and consulting roles, in a fashion similar to recent reforms to the accounting profession, and
2. Codify in pension standards a fiduciary role for the valuation actuary.

Taken together, these measures would help foster an appropriate separation between the business interests of the plan sponsor and the valuation of the pension fund.

Second, the panel should support calls for a reform of the federal *Bankruptcy and Insolvency Act*, giving unfunded liabilities in pension plans secured creditor status. This would remove existing perverse incentives for employers to:

- a) Extract notional surplus from DB pension plans through contribution holidays, then creating an unfunded liability by adopting more conservative actuarial assumptions, and
- b) Using bankruptcy proceedings to rid themselves of an expensive and underfunded DB plan.

The AFL believes that reforming the actuarial function in occupational pension plans and improving the protection of pension benefits in bankruptcy proceedings would contribute to the maintenance and protection of defined benefit pensions in Canada.

The discussion paper identifies existing disclosure standards as an “irritant” for plan administrators. The AFL finds this attitude puzzling. Since plan members bear the risk of reduced benefits if plans become insolvent, they have a legitimate interest in the financial status of the plan, and in knowing how the plan is being funded. Plan administrators should be required to provide unions (where present) and plan members (on request) with relevant information about the plan, including contributions made, any use of surplus, and actuarial valuations. Since this information is already available to plan sponsors, it is unclear why providing it to workers and/or their bargaining agents should constitute an “irritant.”

¹⁰ *Ibid*, p. 34.

Related Legal Frameworks

The discussion paper raises the contentious issue of whether pension plans are trust arrangements or employment contracts, and broaches the question of a legislative intervention in favour of the latter view. In the view of the AFL, such an action would amount to the expropriation of billions of dollars in existing or potential future pension surpluses from millions of Canadian working people. The legal, political and social consequences of any such action would be incalculable, and we urge the Panel to dismiss the suggestion.

Conclusion

Given time and other constraints, it has not been possible for the AFL to address all, or even a majority of the questions posed by the Panel in its discussion paper. This should not be taken as meaning the AFL isn't interested in the remaining questions. On the contrary: we are interested in these issues, and we look forward to further participation in the review process. We hope that other stakeholders will make submissions discussing the issues we have been unable to address.

In this regard, we particularly note the submission to the Panel made by the Shareholder Association for Research and Education. The AFL supports the SHARE brief and its recommendations.

We thank the Panel for the opportunity to participate in this consultation.

Summary Recommendations

1. The Panel should reject any suggestion that labour market or human resource issues can be addressed through changes to the benefits offered by public pensions (for example: by raising the retirement age).
2. The Panel should resist policy proposals to make occupational pension plans more attractive to employers by skewing pension standards legislation against workers and in favour of employers (for example, by making it easier for employers to access to surpluses).
3. The Panel should call on federal and provincial governments to enter into discussions aimed at improving and expanding benefits from existing public pensions, including Old Age Security and the Canada Pension Plan.
4. The Panel's report should include a discussion of ways of achieving uniform pension standards across the country, including the possibility of a single national pension standards statute and a single national regulator.
5. The AFL suggests that, in general, pension standards regulations should be specific and rules-based. This should be reflected in any changes the Panel recommends to British Columbia or Alberta pension standards.

6. The Panel should decline to recommend any changes to pensions standards aimed at making it easier for employers to access surplus in occupational defined benefit pension plans.
7. The Panel should recommend reforming the actuarial function in occupational pension plans:
 - a. Separating the valuation and consulting functions of actuaries.
 - b. Codifying a fiduciary role on actuaries performing a valuation function.
8. The Panel should recommend that the governments of British Columbia and Alberta urge the federal government to amend the *Bankruptcy and Insolvency Act* to give unfunded pension plan liabilities secured creditor status.
9. The Panel should adopt a guiding principle a commitment to greater transparency in occupational pension plans. Plan administrators should be required to make available to members and (where applicable) their unions information on contributions, surplus use, and actuarial valuations (including the assumptions used in such valuations).