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Submission in Response to

***Enhancing Retirement Security for Canadians: Consultation
Document***

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Introduction

I am pleased to respond to the consultation paper *Enhancing Retirement Security for Canadians: Consultation Document*. I take full responsibility for any shortcomings in this submission but wish to acknowledge the helpful support of my colleagues on the Expert Panel on Income Security of the Ottawa Council on Aging.¹ My credentials for addressing the issues raised in the consultation document are noted in the footnote below.²

A basic premise of the consultation is that “... Canadians deserve a safe, secure and dignified retirement ...”. We whole heartedly endorse this premise. We also make positive note of “... the Government is seeking feedback ... in order to take a whole-of-government, evidence-based, approach towards addressing retirement income security for all Canadians.”

Despite the positive point of departure for the consultation paper and process, the subject matter of the consultation paper is narrowly constructed in a double sense. First, the paper focuses primarily on the financial problems of defined benefit (DB) pension plans – especially in the context of bankruptcy. Second, the range of “Options for Stakeholder Comment” is rather narrow. The issues that are raised in the consultation paper are important issues but they are an incomplete menu of options for addressing retirement security issues. Even if we keep our focus on the security of benefits provided by DB plans, there are many issues that need to be addressed that will not be addressed if the current consultation is limited to the issues raised in the consultation document.

Taken at face value, the title of the consultation document would invite a much wider scope of investigation and public dialogue. Within the realm of workplace pension plans (WPPs) one would expect some discussion of the limited degree of participation in WPPs and some discussion of the shift from DB to defined contribution (DC) plans. Moreover, a complete discussion of retirement income security would also encompass a discussion of the role and design, the level of benefits and the age of eligibility of Canada’s publicly administered plans:

¹ Panel members are: Bob Baldwin, Bernard Dussault, Peter Hicks, Andrew Jackson, Russell Robinson (chair), Jennifer Robson, Richard Shillington, John Stapleton and Michael Wolfson

² I have been working on pension issues for more that forty years – roughly 30 as the pension specialist at the Canadian Labour Congress and the remainder as a consultant. In addition to my participation on the Expert Panel of the Ottawa Council on Aging, my current pension related duties include: chairing the board of trustees of a multi-employer pension plan, serving on the board of directors of a fund management company and a mutual fund company, being a member of the Pension Policy Council of the CD Howe Institute and being a member of the research advisory committee of the National Pension Hub of the Global Risk Institute. In addition, over the last several years I have had research papers published by: the Canadian Labour and Employment Law Journal, the Canadian Public Pension Leadership Council, the CD Howe Institute, the Institute on Research and Public Policy and the Institute on Municipal Finance and Governance. Some past activities of note include: being a member and chair of the CPP advisory committee (renamed the board in 1986), being an expert advisor to the Ontario Expert Commission on Pensions and, being a director of PSP Investments.

Old Age Security, the Guaranteed Income Supplement and the Canada and Quebec Pension Plans. When my colleagues on the Expert Panel and I discuss retirement income security, all of these issues are part of the discussion and their interdependent nature is taken into account.

We don't wish to minimize its importance, but we do note that the current consultation is addressing a narrow slice of the retirement security of Canadians. Should the current exercise be broadened at a later date, the Experts Panel would welcome the opportunity to provide advice and assistance.

Need for a Strong Evidence Base

The consultation paper and process should be seen in light of the government's commitment to an evidence based approach to decision-making. The issues that are on the table cannot be resolved in the absence of quantitative assessment of the options that are open.

There are strong tensions between the measures that might be adopted to increase the security of DB benefit promises and other reasonable objectives. In the consultation document, these tensions are noted mainly as tensions between enhancing DB benefit security and policy objectives outside the retirement income system (RIS). But, it is important to recognize that even within the realm of DB pension plans, there are important tensions between the pursuit of benefit security and other objectives – most particularly the provision of adequate benefits at a reasonable cost.

It is also important to note that some measures that might increase benefit security have different impacts on different groups of plan members. For instance, a proposal that would only enhance the security of accrued benefits would have a positive impact on retired plan members but not provide much in the way of enhanced security for young and future plan members.

It is not possible to make a reasonable judgement on how these tensions should be resolved if the only information available is purely qualitative. The consultation process would be much better informed if the government would provide some degree of quantitative assessment of the tensions it has identified and those raised in the preceding paragraph. We raise this possibility recognizing that doing so is not a small challenge.

The consultation document includes a number of possible changes to pension regulations, bankruptcy legislation and corporate law that might contribute to increased security of DB benefits. From our perspective, none are inherently wrong. But in the absence of further analytical work, it is hard to know whether the potential benefits of the possible changes offset the potential negative effects. Moreover, because the possible changes identified in the consultation document represent a relatively small subset of things that might be considered, it is unclear whether the changes suggested in the consultation document represent the most effective changes. We note too that some of the changes mentioned in the consultation document would move the regulatory law in a direction that is quite different from its past.

The Regulatory Law: The Dead Weight of History

Canada's first regulatory law came into effect in the mid 1960s when the *Pension Benefits Act* (PBA) of Ontario took effect. The Ontario PBA established a substantive pattern for similar regulatory laws in other jurisdictions that were introduced within a decade or so after the mid 1960s. Several features of the original PBA still characterize pension law more than 50 years later:

- The law was designed primarily to protect members of DB plans from errors or misdeeds of the employers who sponsor the plans.
- The law presumed that the governance structure of DB plans would be dominated by employers.
- The law was "rules based": as long as an employer plan sponsor followed the funding and other rules, they had no further obligation to the plans.

Since the mid 1960s, there was a major round of amendments to the regulatory law in the late 1980s. This round of reform was co-ordinated by the federal and Ontario governments. It led to changes in regulatory law across the country and included some important steps forward in protecting plan member rights. But with minor modification, the characteristics of the 1960s law just noted remained in place.³

Over the years many things have changed in the world of WPPs. In both the 1960s and 1980s it seemed reasonable to think of WPP design in terms of a binary choice between DB and DC plans. In the face of financial and demographic changes, WPPs in Canada and abroad have evolved into a spectrum of choice with plans incorporating elements of both DB and DC. The regulatory law has trailed this evolution by adding patches to the old legal framework to try to keep pace with new developments. But the kind of basic reform advocated by the Ontario Expert Commission on Pensions has not been undertaken.

Even at the time that the original PBA was taken effect, there were union initiated multi-employer pension plans (MEPPs) in existence. These plans differed from traditional DB plans in two key respects. First, their governance structure involved shared governance between employee representative and employers, or plan member representatives alone. Second, these plans were allowed to reduce accrued benefits in the face of financial difficulties. In contemporary terms they would be described as target benefit plans. Legal provision for the operation of these plans was established through special provisions of PBAs.

The experience and legal treatment of the MEPPs is significant to the issues identified in the consultation document. It raises an important question: in WPPs where plan members can assert their interests through the plan governance process, is the same degree of rules based regulatory

³ The 1980s reforms included the introduction of solvency funding requirements, shorter vesting periods and portability measures, measures to address gender equity and enhanced information disclosure to plan members.

guidance needed for WPPPs where the governance structure is dominated by the employer plan sponsor?

One feature of the 1980s reforms provides an insight into why it is difficult to reconcile enhanced security of DB benefits with other pension objectives. All Canadian jurisdictions introduced solvency funding requirements as part of the DB funding requirements in the late 1980s reforms. The solvency funding requirements were more sensitive to market interest rates than were the more traditional going concern discount rates. The use of the more market sensitive measures was supposed to strengthen benefit security. But as interest rates dropped more or less continuously from the late 1980s to the present, the solvency funding requirements kept increasing and the plans became more expensive. The unfortunate unintended consequence was that measures that were supposed to add to the security of DB benefits contributed to the shift from DB to DC plans. Retired members suffered no loss from this transition but young and future members did.

Consultation Issues and a Wider Look at the Regulatory Law

As was mentioned above, we find the consultation document somewhat surprising and disappointing in offering a relatively narrow range of options for addressing the question of how to increase the security of benefits in DB plans. The issues put forward for discussion in the consultation paper may reflect the outcome of a prior process of consultation. But from the perspective of an organization that was not involved in that process, the range of policy options in the consultation paper is narrow.

Having reviewed the consultation document, we asked ourselves the question: what are the possible changes to the regulatory and related laws we would want to consider in order to answer the question about how to improve the security of plan members' benefits? To be clear, in undertaking this exercise, we did not presume that we would respond to all of the possible changes that came to our mind with affirmative responses. But in each case we did think the issue was worth considering.

In Box 1 below we provide a list of things that ought to be considered in trying to increase the security of DB benefits. We have put asterisks beside the items that are listed in the consultation document. As a share of all of the possible things to consider, the ones marked with asterisks are small share - particularly with respect to the regulatory law.

Box 1

Possible Changes in the Laws that would Increase the Security of DB Benefits

Pension Benefits Standards Act

- Shorten periods for amortizing unfunded liabilities
- Mandate lower (market) discount rates used in actuarial valuations
- Mandate more conservative investment policies
- Mandate liability matching investments (reflecting changes in the balance of liabilities between active and retired members)
- Link funding targets to investment risk (as equity portions of portfolios increase, so would the funding target)
- Link funding targets to the credit worthiness of the plan sponsor
- Link funding targets to plan maturity (e.g. the ratio of active to retired lives)
- Move from a rules based regulatory regime to a principles/objectives based regime or a mix of the two
- Require greater separation in plan governance between pension plan trustees and employer plan sponsors
- Introduce Solvency Reserve Accounts that employer plan sponsors could use to match liabilities in difficult times but which could be run down in good times*
- Attach criteria to ministerial grants of funding relief such as limiting dividend payments*
- In the case of plan termination, permit transfers to individually managed accounts. (At present the purchase of annuities is the only option)*

Introduce a pension insurance scheme like Ontario's pension benefits guarantee fund and similar organizations in the US and UK.

Heighten the status of actuarial deficits in bankruptcy proceedings*

- unfunded pension liabilities and employee benefits would be paid ahead of secured creditors

In cases of bankruptcy of employers who sponsor pension plans with unfunded liabilities, allow courts to order the recovery of payments made to shareholders and executives over five years rather than one year.*

Make bankruptcy proceedings more transparent*

Amend corporate law to align the interests of the corporation and the pension plan by limiting dividend payments, share buybacks and executive compensation if pension plans have large deficits and enhance corporate reporting in employee interests including the pension plan.*

Several things about this list bear emphasis.

The first several items listed under the Pension Benefits Standards Act (PBSA) heading would fit quite easily within the framework of the current PBSA. But the items starting with “Move from a rules based regulatory regime to a principles/objectives based regime” present more fundamental challenges to the existing regulatory regime. These more fundamental challenges need to be addressed at some point in time to take account of the greater array of benefit designs that are coming into being along with the need for plan governors to be able to take account the specific features of their plan, including its maturity. In the context of a more flexible, less rules based regulatory environment that we envisage in the future, the role of plan member representatives in the plan governance structure needs to be considered. If the interests of plan member cannot be protected by regulatory rules, it will be important for plan members to be able to protect their interests through their participation in plan governance.

The “Options for Stakeholder Comment” that are included in the consultation document do not raise these more fundamental challenges directly. But, we are struck by the fact that some of the options would require the employer sponsors of DB plans to exercise discretion with respect to the financial management of their DB plans in a way that goes beyond simple compliance with pension financing rules. We have no objection to a move in that direction. But moves in that direction should be considered in the context of a broader reflection on whether regulatory and plan governance need to be redesigned to better combine the protection of plan member interests with the need for more regulatory flexibility.

One striking feature of the consultation document is its emphasis on the limited scope of the federal jurisdiction with respect to the regulation of WPPs. At one level this is a straightforward statement of fact. But it also conveys the message that the federal government does not see itself playing a leadership role in trying to co-ordinate multi-jurisdictional efforts to modernize Canada’s pension regulation along the lines suggested by the Ontario Expert Commission on Pensions. This is highly regrettable.

Two further things should be acknowledged about Box 1. First, there are interdependencies among items listed in Box 1. For instance, the appropriate amortization period needs to be considered in conjunction with the credit worthiness of the plan sponsor. Second, the way in which the listed issues are resolved will depend on whether a going concern or termination accounting method is being contemplated.

Conclusion

Enhancing Retirement Security for Canadians: Consultation Document addresses a very important issue – how to enhance the protection of DB benefit promises especially in the context of the bankruptcy of DB plan sponsors. The document presents some options for reforming pension regulation, bankruptcy law and corporate law to address this issue and the options presented are worthy of consideration.

As is implied in the consultation document, the issues that need to be addressed cannot be addressed in a one sided manner. While the consultation document focuses attention on tensions between protecting DB benefits and non pension objectives, the tensions also exist within the pension realm. Measures that might enhance the protection of DB benefits in the context of the bankruptcy of DB plan sponsors also need to make sense in the context of ongoing DB plans.

Given the government's commitment to evidence based decision-making, it is worth giving some attention to whether the current publicly accessible information about WPPs is adequate to support well informed public policy discourse.⁴ Many problems and issues could be raised in this area. A few that come readily to mind include: problems in classifying WPP benefit design in view of new adaptations in benefit design, limited data on pension investments, no data on the funded status or maturity of DB pension plans, actuarial discount rates and no data on combined employer and employee contributions to DC plans. We also note the absence of data on group RRSPs in spite of their widespread use.

We appreciate the positive features of the consultation document. At the same time we don't believe the document provides an adequate basis for resolving the issues it raises. The analytic support for the various options is incomplete and so is the range of options it presents. The range of options is incomplete even if our exclusive focus is WPPs. Key issues such as the rate of participation in WPPs and the shift from DB to DC are not addressed. Nor are issues related to the overall design of Canada's RIS.

⁴ There are also data problems faced by governors of DB plans. I will address these in a future publication.