Financial and Corporate Sector Policy Branch
Ministry of Finance
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January 31, 2019

Re: Pension Solvency funding

Our seniors have worked hard all their lives and deserve to have their savings, investments and pensions protected. The B.C. government needs to ensure residents of this province can live out their lives with financial security and certainty.

Improving retirement security for B.C. residents will not only make seniors safer, it will save the government money.

About CARP

CARP is an advocacy organization that works to improve the lives and uphold the rights of Canadians as we age. We have 300,000 members across the country, with chapters from White Rock. B.C. to Avalon, Newfoundland and offices in Toronto, ON and Surrey, B.C.

Next Steps

CARP welcomes the opportunity to make this submission and would be pleased to comment further or meet with MLAs or their staff to discuss our views.

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Solvency Funding Framework Review

Objective of the Review

The government of British Columbia is reviewing the province's solvency funding framework for defined benefit (DB) pension plans to assess whether it should be changed so that it better supports plan sustainability and benefit security over the long-term, in a way that balances the interests of all pension stakeholders.

The consultation document notes that an important objective of this review is to support the continuation of existing DB pension plans and the creation of new DB pension plans.

CARP Urges Refocus of Review Objectives

CARP respectfully submits that trying to sustain or grow defined benefit pension plans is a flawed premise for the review. According to Statistics Canada, private defined benefit pension plans in B.C. are in decline:

			Total private defined benefit plans in B.C.[i]				
		2013	**2014**	**2015**	**2016**	**2017**	**Percent decrease since 2013**
Total of registered pension plans	Plans	696	685	664	652	632	9.2%
	Active members, both sexes	174,346	178,075	177,113	172,299	170,253	2.3%

This decline is not just happening in B.C. but is occurring across the country. According to Statistics Canada, the number of private pension plans in Canada has dropped by 9.5 percent over the past 5 years while plan membership has decreased by 0.6%.

Rather than watering down existing rules in the hope of reversing the decline of private defined benefit plans, CARP recommends the B.C. government focus on protecting the pension benefits already earned by people in existing plans.

B.C. is a retirement destination of choice for older Canadians (net in-migration to B.C. for those 55 and over from July 1, 2013 to June 30, 2018 was 18,585).[ii] The impact of unprotected pensions will be particularly felt in this province as pensioners move here to retire. CARP urges the B.C. government to reconsider the objective of this review and focus instead on how to lead the country in protecting defined-benefit plan members.

Solvency Funding Framework Review

Comparative Jurisdictions

The consultation document provided by the B.C. Government included comparative funding requirements of other provincial jurisdictions.

CARP respectfully submits that the exclusion of the federal government's funding requirements is an omission that must be rectified.

Here are the solvency funding requirements for federally-regulated plans:

> *Federally regulated pension plans are required to be 100 per cent funded on a solvency basis, with any shortfall paid by the employer within five years in order to help ensure that plans have sufficient assets to provide for all benefits, both while the plan is ongoing and in the event of plan termination. This serves to protect the rights and interests of plan beneficiaries. At the same time, employers are permitted to amortize deficits over a prescribed period in recognition that pension plans may have, at times, a deficit too large to address all at once without harming the financial integrity of the employer. In this way, federal pension plan funding standards strike a balance between benefit security for plan beneficiaries and flexibility for the employer.*[iii]

Rather than joining other provinces in a race to erode pension protections, CARP respectfully submits that B.C. retain its current solvency funding requirements which match the federal requirements above.

CARP believes that more appropriate comparators are the U.K. and U.S. where companies may become insolvent, but substantially all pension plans are protected with guaranteed annual pensions up to $67,295 U.S. ($89,883 CDN)[iv] and £39,006 ($65,744 CDN)[v] respectively.

CARP's Recommendations for Strengthening Pensioner Protections

CARP respectfully submits that the current imperative is not to weaken pension protection by diluting funding requirements, but to strengthen pension protection by bringing in supplementary measures currently used by other jurisdictions.

CARP recommends that the government of B.C.:

1. **Create a B.C. Pension Benefit Guarantee Fund.**

   Create a provincial Pension Benefit Guarantee Fund to fully insure all defined benefit pensions. Once implemented, this would secure similar rights for B.C. pensioners as those of pensioners in the U.K. and the U.S.

   The U.K. plan guarantees £39,006 which is 99% of the average retiree *household* income

of £39,200.[vivii] The U.S. plan guarantees $67,295 U.S. which is 117% of the median income of all U.S. *households* of $57,652 U.S.[viiiix]

2. **Require Pension Plans to be Fully Funded Prior to Sale of Company**

   Where the sale of a company with an unfunded pension liability is contemplated, require the pension to be fully funded prior to sale, or require that the regulator and pension plan members consent to the sale.

   The regulation put in place by the provincial government in July 2018 (requiring full funding of Catalyst Paper Corporations DB Pension Plan for Salaried Employees in the event the company is sold or enters insolvency protection) is an excellent example of proactive pension protection. This has directly and positively impacted the retirement security of Catalyst's salaried pensioners.

3. **Abolish Universal Pension Funding Relief**

   Where corporations are seeking funding relief, such as allowing longer periods to make up deficits, allow relief only in those cases where funding would truly be a hardship. In such cases, prohibit share buy backs, dividends and executive bonuses and other special compensation until pensions are once again fully funded on both a going concern and insolvency basis.

4. **Improve Pension Plan Disclosure**

   Increase disclosure requirements for B.C.-regulated companies with defined benefit pensions. For any plans that are not fully funded on both a going concern and solvency basis, prohibit dividend increases or share buy backs.

5. **Create Canada Pension Plan Plus**

   Work with the federal government to create an optional, incremental, Canada Pension Plan, *Canada Pension Plan Plus,* where CPPIB invests the assets and Canada Revenue Agency (CRA) and Employment and Social Development Canada (ESDC) jointly administer the plan. The combination of risk pooling, solid returns and low administration fees enjoyed by the Canada Pension Plan would significantly contribute to the financial security of defined contribution pensioners, and be particularly beneficial to those with low financial literacy.

6. **Enable Orphaned Plans to Continue Operations**

   Provide an option for orphaned pension plans of insolvent companies to continue to operate, so that pensioners are not left with decreased assets due to a forced wind-up at fire sale prices and the (comparatively) high cost of annuitization.

   This could be done through Canada Pension Plan Plus (see 5 above) or by allowing existing pension plans to offer this service as in done on an ad hoc basis in Ontario and Quebec.

Our responses to the specific proposals outlined in the consultation document follow as an appendix to this document.

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Appendix: Responses to Specific Proposals

Approach A: Modifications to Current Solvency Funding Rules

Approach A presents options for changes to existing solvency funding requirements to address the varied interests of stakeholder groups.

Option 1: Lengthened Amortization Period

The Pension Benefits Standards Act (PBSA) currently requires solvency shortfalls to be paid within five years. The period of time over which solvency shortfalls must be paid could be lengthened (e.g., to 10 years).

Increasing the payment period would address both the volatility and size of solvency payments for underfunded pension plans.

CARP's response:

CARP is not supportive of lengthening the period of time over which solvency shortfalls must be paid. In particular, CARP strongly opposes blanket extensions which can be used by companies to defer pension payments even in the absence of cash flow challenges.

We note that as of 2013, nearly four in five (78%) existing defined benefit pension plans were underfunded on a solvency basis. By 2016 two in three (66%) were still underfunded while the plans with significant underfunding (less than 85%) had increased from 21% to 23%.

Lengthened amortization periods provide no benefit to plan members while significantly increasing their risk of harm.

B.C. Plans by Solvency Funding Ratio, 2013[xxi]		
Solvency Ratio	**Number of Plans**	
	2013	**2016**
Less than 85%	30	43
85% but less than 90%	20	21
90% but less than 100%	62	63
100% but less than 110%	32	39
110% or more	0	25
Total	144	191

Option 2: Consolidation of Solvency Deficiencies

Under the PBSA, if a plan has a solvency shortfall at a valuation date, the shortfall must be paid

based on a five-year amortization schedule. If another solvency shortfall is identified in the next valuation, a new five-year amortization schedule is established for the required payments. Instead of requiring a successive series of solvency payments to be made, solvency shortfalls could be consolidated and paid based on a new amortization schedule established at each valuation date (i.e., a "fresh start" approach).

Similar to Option 1, a "fresh start" would address both the volatility and size of solvency payments for underfunded pension plans.

CARP's response:

CARP is not supportive of consolidating solvency deficiencies. We respectfully submit that this simply allows plan sponsors to defer their pension obligations. Given the cyclicality of business cycles, this may result in pensions plans which are perpetually underfunded.

Option 3: Basing Solvency Funding on Smoothed Asset Values

The PBSA requires solvency funding shortfalls to be determined based on the market value of plan assets.

However, short-term fluctuations in market values result in volatile solvency funding requirements. An asset valuation method that "smooths" the recognition of investment-related gains or losses over a specified period could be used to moderate the volatility of solvency funding costs. The period should not be longer than the typical length of an economic cycle. This option would moderate the volatility of solvency funding costs by deferring the recognition of investment gains and losses.

CARP's response:

CARP does not support insolvency funding based on calculations using smoothed asset values.

When a private plan sponsor becomes insolvent, pensioners' assets are not protected simply because asset values were higher in previous years. As pension plan assets are liquidated - and annuities purchased - at this same time, a smoothing approach would do little to minimize the risk of pension shortfalls. Insolvency funding principles must match pension plan liquidation practices.

While annuities carry a high level of security, crystallizing plan losses in order to purchase annuities may not be in the best interest of plan members. CARP recommends the B.C. government investigate the feasibility of enabling orphaned plans to continue to operate.

Option 4: Basing Solvency Funding on an Average Interest Rate

Interest rates used in a solvency valuation are those recommended by the Canadian Institute of Actuaries (CIA) as the basis for a hypothetical wind-up valuation. The solvency liability for benefits in a single-employer DB pension plan that are expected to be settled by an annuity purchase (typically, pensions) is calculated as the cost of replacing the pension obligation with a life annuity from an insurance company. The solvency liability for benefits that are expected to be settled by a lump-sum transfer is calculated on the commuted value basis. Both are based on interest rates and mortality assumptions established by the CIA from time to time.

The interest rate assumption used to calculate solvency liabilities for pension obligations could be replaced by one based on the average of the CIA interest rates over a specified period before the valuation date. The period should be long enough to be effective in dampening the volatility of solvency funding requirements, without being overly long so that the impact of changing interest rates may be inappropriately delayed.

This option could moderate the volatility and high level of solvency funding payments or, in the case of negotiated most plans, benefit reductions, by mitigating the impact of falling or rising interest rates on solvency funding requirements.

CARP's response:

CARP supports limited interest rate averaging in determining insolvency funding.

The market value of a long-term debt instrument will vary significantly with small changes in interest rates. The cost of annuities will likewise be sensitive to changes in interest rates and may result in extreme volatility in funding requirements.

Insolvency funding principles must match pension insolvency practice. As annuities must be purchased on plan dissolution, averages should only be taken over the short-term.

Option 5: Funding a Percentage of the Solvency Liability

The required level of solvency funding could be reduced from 100 per cent to a lesser percentage of the solvency liabilities, reducing solvency payments.

This option would address sponsoring employers' concerns about high solvency payments, while continuing to provide benefit security to a specified solvency funding level. Given that few employers are at risk of insolvency at a particular time, this option may adequately protect benefit security while moderating employer contributions.

CARP's response:

CARP strongly rejects any reduction in solvency liability funding.

Current rules require 100% solvency funding, yet the vast majority of plans are under-

funded.[xii]

The B.C consultation notes that "few employers are at risk of insolvency at a particular time". This is irrelevant. One insolvent company with an under-funded pension plan is one too many.

B.C. should heed the lessons of Nortel and Sears and ensure that other pensioners never face the prospect of having their life savings deleted and their retirement security wiped out.

Pension protection has faltered because governments in certain times and jurisdictions have believed that companies are "too big too fail". If this ever held true it certainly does not now.

CARP respectfully submits that any dilution in required solvency funding is damaging to pensioners and must not be permitted.

Approach B: Replace Solvency Funding Rules with Enhanced Going Concern Funding Rules

Some pension stakeholders have expressed concerns with the premise of solvency funding; that is, to fund a pension plan assuming the pension plan will wind up on the valuation date. DB pension plans are often viewed as a long-term investment in the employees in a particular workplace or industry. Going concern funding assumes a pension plan will continue indefinitely and some see going concern funding as a more appropriate funding approach. In addition, stakeholders have expressed concern with the volatile and procyclical characteristics of solvency funding.

CARP's response:

CARP does not support the replacement of solvency funding rules with enhanced going concern funding rules.

Insolvency funding principles must match pension plan liquidation practices. The current practice in B.C. is for the pension plans of insolvent sponsors to be annuitized, i.e. liquidated. It is a fundamental mis-matching of policy and practice to allow going concern funding principles for an asset that is by legislation required to be liquidated.

It may be appropriate to consider options other than forced annuitization of plan assets. CARP recommends the B.C. government investigate the feasibility of enabling orphaned plans to continue to operate. Such a change in pension plan practice would merit a discussion of change in pension plan policy.

Additional Complementary Reform Measures - Modifying Commuted Value Transfer Rules

The commuted value of a member's benefit is the amount of money that needs to be provided today, using current interest rates, in exchange for the benefit to which the member is entitled under the pension plan. Standards established by the CIA prescribe the actuarial methods and assumptions for calculating an individual's commuted value, including the interest rate and mortality assumptions used in the calculation.

When an individual terminates employment with an employer, they may, if eligible, elect to transfer the commuted value of their benefits from the pension plan to a locked-in Registered Retirement Savings Plan or other permitted financial instrument instead of leaving their benefits in the plan. The PBSA requires 100 per cent of the commuted value to be transferred if the plan is fully funded on a solvency basis. In the current environment of persistently low interest rates, commuted values are high, as a greater amount of money is required to be set aside to pay for the individual's future pension. This creates a financial risk for pension plans, as it is typically now more expensive for a plan to pay commuted values than to pay pensions as they fall due.

CARP's response:

It is far more efficient for Canadians to meet their retirement goals through pooled pension plans than individual savings. According to a report recently released by the Healthcare of Ontario Pension Plan, "From a retirement "bang for buck" perspective, for each dollar contributed, the retirement income from a Canada-model pension is $5.32 versus $1.70 from a typical individual approach."[xiii]

Allowing individuals to withdraw the commuted value of their pension not only requires excessive pension funding, but also puts the individual plan member at risk due to the higher investment fees and lower returns typically experienced by individual investors[xiv]*.*

While in principle CARP supports lowering the commuted value of a corporate pension to discourage such withdrawals, we recognize that given recent high-profile pension plan failures, individuals may feel they have a legitimate need to safeguard their pensions by commuting them.

CARP calls on the B.C. government to begin pension reform by improving pension protections. Once BC pensioners receive equivalent protections to their peers in the U.S.[iv] *and U.K.,* [v] *then reducing commuted values would be entirely appropriate.*

Endnotes

CARP

[i] Statistics Canada, B.C. Private Defined Benefit Pension Plans, https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110009401&pickMembers%5B0%5D=2.3 Accessed January 30, 2019

[ii] Statistics Canada, Net in-migration to B.C. by age group https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1710001501&pickMembers%5B0%5D=1.11&pickMembers%5B1%5D=2.1&pickMembers%5B2%5D=3.1 Accessed January 30, 2019

[iii] Enhancing Retirement Security for Canadians (Federal Consultation document on pension protection). https://www.ic.gc.ca/eic/site/116.nsf/eng/00001.html Accessed January 30, 2019

[iv] https://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee In 2019, the maximum annual pension benefit payable for a 65-year-old (without a survivor) is $67,295 US or $89,883 CDN.

[v] https://www.ppf.co.uk/sites/default/files/file-2018-10/compensation_cap_1_april_2018_0.pdf As of April 1, 2018 the maximum pension benefit insured for a 65-year-old is **£**39,006 or $65,744.

[vi] Average U.K. retiree household income: https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/averageincomestaxesandbenefitsbyquintilegroupsofretiredhouseholds Accessed January 31. 2019

[vii] https://www.ppf.co.uk/sites/default/files/file-2018-10/compensation_cap_1_april_2018_0.pdf As of April 1, 2018 the maximum pension benefit insured for a 65 year old is **£**39,006 or $65,744.

[viii] https://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee In 2019, the maximum annual pension benefit payable for a 65-year-old (without a survivor) is $67,295 US or $89,883 CDN.

[ix] Median U.S. household income: https://www.census.gov/search-results.html?q=average+income&page=1&stateGeo=none&searchtype=web&cssp=SERP&_charset_=UTF-8

[x] A Profile of Defined Benefit Pension Plans in British Columbia (2013 data) https://www.fic.gov.bc.ca/pdf/pensionplans/DefinedBenefitProfile.pdf Accessed January 30, 2019

[xi] Report on Pension Plans Registered in British Columbia https://www.fic.gov.bc.ca/pdf/pensionplans/ReportOnPensionPlans2017.pdf 2016 data, Accessed January 30, 2019

[xii] See table in this document Solvency_Ratios_Table

[xiii] The Value of a Good Pension: How to improve the efficiency of retirement savings in Canada, 2018 Healthcare of Ontario Pension Plan, 2018. https://hoopp.com/docs/default-source/about-hoopp-library/advocacy/the-value-of-a-good-pension-102018.pdf Accessed January 30, 2019

[xiv] CARP has written extensively on this subject in other publications. See for example, our submission to the Federal Government on protecting retirement security. http://www.carp.ca/2014/11/19/carps-submissions/