CUPE

Submission

by the Canadian Union of Public Employees (CUPE)

to the

Department of Finance Canada's

Consultation Paper entitled

"Pension Innovation for Canadians: The Target Benefit Plan"

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The Canadian Union of Public Employees (CUPE) is the largest union in Canada. We represent 627,000 members in over 2,000 local unions working in diverse sectors for both public and private employers in communities all across Canada. 60 of these local unions are in federally regulated industries and sectors.

CUPE endorses the submission of the Canadian Labour Congress to this consultation, but has some additional comments which follow below.

Study after study show that Canadians are not saving enough for retirement and that the country is walking, with eyes wide open, towards a retirement income crisis in the coming decades.[1] Without better pensions for all Canadians, we will be facing a future of more seniors living in poverty, or near poverty – quite simply, a future of suffering. This will cost future taxpayers in many different ways. We could await this fate or we could act now to improve the retirement security system. The most urgent need is to be working on better pensions for all workers through an expansion of the Canada Pension Plan, not attacking retirement security as the government has done, (with its attacks on OAS-GIS, its obstruction on CPP expansion and its ineffective PRPP alternative) and continues to do in this discussion paper. The government's target benefit (TB) plan proposals are deeply offensive to CUPE. We do not see a government primarily concerned with retirement security of Canadians, we see a government that is really interested in allowing employers to abandon defined benefit (DB) plans, not only for the future, but also for all of the DB promises they've made in the past.

Target Benefit plans are not new and are not innovative

The government presents target benefit plans as "pension innovation," however target benefit plans are certainly not new in Canada's pension landscape. They have occupied a limited and specific terrain in this landscape, and for good reason. Target benefit plans have existed for decades in sectors like construction and in certain segments of the public sector where employers tend to be small, less established or transient. Employers in these sectors have traditionally not been sponsors of defined benefit plans. Sometimes the jobs are sporadic and the workforces temporary. Sometimes the employers are just too small to deal with the administrative requirements of running a defined benefit plan. These factors have meant that these employers were reluctant or unable to offer traditional defined benefit plans. Thus, workers in these sectors were often left with nothing but a minimal RRSP-style plan at work, or a defined contribution (DC) plan, or no pension plan altogether. Primarily at the initiative of labour unions, multi-employer target benefit plans were established in these sectors. These plans were characterized by fixed contribution rates and benefit levels that could be adjusted if circumstances required. Since plan members were effectively bearing the risk in these plans, they justly retained effective control of the plans. Employers had no control over these plans and generally were not permitted to reduce their annual contributions to the plans. CUPE was instrumental in the

[1] Michael C. Wolfson, "Projecting the Adequacy of Canadians' Retirement Incomes," IRPP Study No. 17, April 2011; CIBC, "Canadians' Retirement Future: Mind the Gap," In Focus, February 20, 2013; University of Waterloo and the Canadian Institute of Actuaries, "Planning for Retirement: Are Canadians Saving Enough?", June 2007.

establishment of two such target benefit plans: the Nursing Homes and Related Industries Pension Plan and the Multi-Sector Pension Plan. Because target benefit plans allow for the pooling of costs and risks, they were much more efficient than the individualized approaches otherwise available for these workers. Thus, target benefit plans were a clear step up for these workers. These plans continue to grow to this day and their members continue to benefit from something better than the mere individualized approach to retirement security that was otherwise available to them. Since they assumed all of the risk in the plan, they were able to control their plans entirely and have steered them in positive directions.

Target benefit plans are much riskier for plan members than defined benefit plans

However, when compared to the defined benefit model, a target benefit plan is a much riskier approach for retirement security for members. The defined benefit structure provides a specific benefit formula, backed up by a legal requirement to fully fund that promise. The result is that retirees know exactly what they will receive in retirement and will therefore retire with real security. The target benefit structure, on the other hand, does not provide a known, legally-binding pension payment. Instead it provides a “target” pension based on projections. However, if the plan is ultimately unable to fully fund those targets, it is permissible to reduce pensions – both on a go-forward and a retroactive basis. Thus, both active and retired members could see their pension benefits reduced. It is clear that employees bear significantly more risk in a target benefit plan than they do in a defined benefit plan.

It’s misleading to call TB plans – as the federal government has – “shared risk” plans, as the plan’s risks are largely or fully borne by plan members. It’s also misleading for the government to claim that TB plans retain DB-like “strong level of benefit security and predictability.” We should be clear that the structures that really matter in these plans – the legal and accounting principles – are completely at odds in DB and TB plans. Moving from a DB to a TB plan clearly shifts risk from employers to plan members, and the government should be honest and up front about this point.

CUPE and the labour movement have traditionally championed secure DB pensions because we see this security as absolutely essential for retirees. Retirement is a time of life when a senior’s needs can be unpredictable and can often increase, while his/her ability to earn extra income, if needed, is typically diminished or is no longer an option. Simply put, an individual’s senior years are a time of increased, often extreme, vulnerability that can only be offset by the security of a DB pension.

The real purpose of the government’s consultation is an attack on past and future defined benefits

However, CUPE’s principal concern with the government’s consultation paper is that the TB framework as proposed will be, in practice, more of an attack on defined benefit plans and accrued DB benefits (which, as unions have articulated, is deferred compensation) than a step up from an individualized approach of RRSP, DC or PRPP-style plans.

In modest language, in a very brief passage in section 4.8, the discussion paper contemplates a major change that cuts across Canadian pension law's history and would effectively undo longstanding deals. The paper proposes allowing the retroactive conversion of already accrued DB entitlements into target benefits. This is a major proposal with profound implications that is deeply offensive to CUPE members.

In effect, this would allow past pension deals which were enshrined in collective agreements, plan texts, case law and legislation, to be retroactively rewritten for many vulnerable seniors.

Where is the justice in the following scenario: a CUPE member works for decades for a modest compensation package that includes a defined benefit plan. Thus, part of her compensation "deal" throughout her working life was that, in retirement, she will have a secure and predictable pension benefit. This member sacrificed larger wage increases throughout her career in exchange for the benefit of this kind of retirement security. This member made pension contributions throughout her career to meet her obligations under this pension deal. When this member eventually moves into retirement, she lives a modest life, and retains the security of her defined benefit pension. Over the years, her health slowly deteriorates, which increases her costs of living, while completely eliminating her ability to earn more money through labour. However, because her income stream from her pension is adequate and predictable, she can plan appropriately and continue to live a decent and secure life.

The proposal to allow conversions of accrued DB benefits into TB benefits would strip the benefit guarantee from this senior woman's pension. With the stroke of a legislative pen, her pension can now be subject to a reduction that is permissible under the law. She has no means of earning more money and her costs are mounting. Should her plan hit a funding shortfall that challenge will no longer be remedied by an employer obligation to put more money into the plan, it will be remedied by this vulnerable pensioner buying less food, turning down the heat or letting her prescriptions go unfilled. This scenario would be deeply offensive to Canadians, but this is what the government calls pension "innovation."

But remember, this woman had a deal with her employer and was compensated throughout her career based on that deal. Now that deal is broken, and the value of a guaranteed pension is retroactively eliminated, she is, however, not retroactively made whole. This member's secure pension was a form of deferred compensation, but this compensation is now being expropriated without justification. The employer was simply permitted to walk away from an obligation it had clearly made. These obligations could be abandoned not only for retirees but for the past service of active members of DB plans as well.

Walking away from past deals like this has profound financial implications for employers. When an employer makes a defined benefit promise, they have to reflect this obligation in their financial statements. Pension obligations therefore appear as a debt obligation on an employer's books. If the government allows the retroactive conversion of DB benefits into TB benefits, these obligations will simply disappear with the stroke of a pen. This cannot be emphasized enough. The government is considering allowing, without any actual justification, the complete liquidation of DB pension liabilities for these employers. With more than $100 billion in DB liabilities across the approximately 350 DB private plans in the federal jurisdiction, the financial stakes here are incredibly high.

This is shocking, as we think of Canada as a society based on contract law and the simple principle that a deal is a deal. Canadians pay their debt obligations – their mortgages, car payments and credit card bills. If they don't, there are legal consequences to failing to live up to their end of the deals they've made. In this pension proposal, the government is simply permitting employers to completely shirk their past deals and debt obligations, consequence-free.

This is simply unfair, both from legal and moral standpoints. CUPE will be resisting the government's efforts to make such a change permissible with all of the union's capability. In other jurisdictions, such as New Brunswick, other governments are facing the prospect of legal challenges over similar legislation. None of this will serve plan members or Canadian citizens well. **The government should not allow the conversion of DB accrued benefits into TB benefits.**

If the government does pursue allowing this inappropriate option, it's clear that the consent of plan members must be required. CUPE's position is that any changes to member pension plans, since those plans are an integral part of compensation, must be subject to collective bargaining.

This will be a step down, not a much needed step up

The consultation paper and the government's comments on it suggest that the offering of TB plans in the federal jurisdiction is intended to be a step up for workers without pension plans or with DC plans. However, when we consider the massive incentive for employers for conversion of their existing DB plans, it's perfectly clear that, if the recommendations in this paper are adopted, we will see a massive step down for retirement security. When the ability to simply write off their entire past pension promises is on the table, we can expect a massive push from employers to get out of their DB plans, by replacing them with TB plans. While the labour movement has traditionally been supportive of TB plans in specific industries in limited circumstances, we strongly resist the notion that TB plans are an appropriate substitute for DB plans where they already exist, or where they *should* exist. We don't agree that solving our retirement security problems should come in the form of a massive shifting of risk from employers to plan members.

If the government was truly interested in improving the retirement security prospects of pension-less and poorly-pensioned workers, the solution continues to be right in front of them: CPP expansion. CUPE and the labour movement have been championing an expansion of the too-modest Canada Pension Plan since 2009. The real pension crisis is the 6 in 10 Canadian workers without workplace pension plans. CPP expansion has sufficient levels of provincial support and is supported by the Canadian public and pension experts from across the political spectrum. Again, if the government truly wants to improve the pensions of Canadians, it should be pursuing this simple, yet remarkably effective solution.

Yet we continue to see this government attacking retirement security wherever it is found: the unjustified attacks on OAS-GIS, the obstructionism on CPP expansion and now a historic attack on the DB pensions in the federal jurisdiction. This is a strange response to what is clearly an impending retirement income adequacy crisis. It's clear that the government's only answer to this crisis is always, perplexingly, less pension coverage and riskier retirement schemes for workers. This fighting fire with fire will clearly not work, and future generations will pay for this short-sightedness in two ways: 1) future taxpayers will remain on the hook for growing social and income support program costs for an increasing numbers of poor seniors, and 2) through the needless pain and suffering future generations of seniors will have to endure.

The framing of sustainability is too narrow and will not produce a proper debate

Certain ideologically motivated organizations have been quite vocal with claims that DB plans are "unsustainable" and that the traditional pension model no longer works. While pension plans – like all investors – did suffer losses and unfunded liabilities in the wake of the 2008 financial crisis, the experience in the past several years has been quite positive. Our pension system is designed to have the flexibility with market fluctuations, and it permits amortization of deficits over reasonable periods of time. As will be discussed below, plan members are bearing significant portions of the burden of returning these plans to full funding. The fact that our plans have regained very strong financial footing just a few short years after the largest financial crisis in the past 80 years demonstrates the resilience and flexibility of the DB model. We disagree that there is a general crisis of sustainability of pension plan funding in Canada.

The narrow focus on plan sustainability throughout the discussion paper is very troubling to CUPE. Sustainability is presented throughout the paper as though both sides of the table would agree on what "sustainability" is, and how to achieve it. Of course plan members want pension plans that are financially sustainable (as plan members directly and indirectly carry a significant portion of the cost of a pension), but they also want pension plans that provide adequate and predictable benefits. The narrow version of sustainability presented in the paper is a pension plan with no liabilities, with the ability to endlessly reduce benefits and with contribution rates that are subject to hard ceilings that, when hit, force benefit reductions. This is an entirely employer-friendly vision of sustainability that only serves to automatically dump the impact of any negative plan experience onto members. **Our goals cannot be limited to only a sustainable pension system. We have to want a sustainable pension system that delivers secure, predictable and adequate pension benefits**. That's a more complex debate, but it's the only debate that will address the needs and desires of all parties.

Yet, as will be outlined below, this is a debate we've been having at bargaining tables across the country, within the defined benefit framework.

Defined benefit plans actually already share risk

The government's paper states that, in DB plans "plan sponsors are solely responsible for funding deficits." It is often argued that defined benefit plans place all of the plan's risk on employers and taxpayers (in the case of public sector plans). While this may appear to be true based on a very technical reading of plan documents and an employer's typical legal obligations, in reality, risks are actually shared quite widely and effectively through the realities of collective bargaining. CUPE's bargaining experience over the past few years have been instructive on this point. If an employer is required to make additional payments to the pension fund to amortize an unfunded liability, plan members know that they will face downward pressure on wages at the bargaining table. In many cases, employers expressly acknowledge that if they have to put more money into the pension plan in a given year, they'll have less, or perhaps nothing, to devote to wage increases. This reinforces plan members' longstanding view of the compensation nature of pension plans: that the distinction between employer and employee contributions is somewhat artificial and that all pension funding is, in effect, a part of total compensation. Plan members really pay substantial amounts of the pension bill which is paid to them as deferred compensation in the form of pension benefits.

CUPE members have been sitting down with employers across the country – employers who are facing unfunded liabilities and special payment obligations – and we continue to reach reasonable deals that actually see plan members carrying portions of these employer obligations in one fashion or another. In effect, the experience of pension bargaining over the past few years is completely at odds with the notion that employers/taxpayers bear all of the risk in DB plans. As the costs of the 2008 financial downturn came due to pension plans, employers have effectively passed on portions – sometimes significant portions – of this extra cost onto plan members. This means plan members are involved in carrying the burden of DB risk in direct and indirect ways. Of course, this comes after decades of battles for plan surpluses, when employers argued that since they were responsible for unfunded liabilities, they alone should benefit from plan surplus. Now that the bills for unfunded liabilities are coming due, employers are choosing to shirk this historical deal and are seeking to pass the costs onto members. The federal government, for instance, withdrew some $30 billion in surplus from its public sector plans in the 1990s, only to later push changes to prospective benefits onto plan members when the plans were in a modest deficit after the 2008 financial crash. A 2005 study from the Shareholder Association for Research and Education found that most federally registered DB plans had taken at least one contribution holiday between 1994 and 2003.[2] The study also found that this lost revenue would have played a significant role in improving pension deficits: half of the plans with sizable underfunding issues would have actually been in surplus had the holidays not been taken. Even though we haven't equally shared in past rewards, CUPE members are stepping up across the country to actually share the current burden of risk in our pension plans where appropriate.

In other cases, plans are designed to share risk automatically through conditional elements of plans (i.e. benefits like cost-of-living increases to pensioners are conditional and not guaranteed). Our jointly-sponsored plans (JSPP's) feature automatic sharing of responsibility for unfunded liabilities, but they also come with automatic sharing of surplus and governance.

As stated above, the "shared risk" moniker is completely inappropriate for TB plans. We would argue that the experience of DB plans over the past several years is actually the best pension model to share

[2] Shareholder Association for Research and Education, author Gil Yaron, "Taking a Holiday: The Impact of Employer Contribution Holidays on the Funding of Defined Benefit Pension Plans," June 2005.

risk through a democratic, bargained process. We think this is a much better way to meet the goals we outlined above – not just sustainability, but also benefit security, predictability and adequacy.

The government's TB proposals would upset the traditional link between plan governance and risk

Traditionally, pension plans have seen a link between plan governance and risk allocation. Generally, those who bear the risk have controlled the plan – a principle the government is seemingly in agreement with in its paper. The traditional target benefit model, as discussed above, left plan governance entirely in the hands of plan members, which was appropriate since members bear the plan risks in a target plan. The JSPP model generally allocates risk and governance proportionally between employers and members. Plan members usually bear half the risk and have half of the governance in these plans. The JSPP governance model has worked well throughout the financial crisis, with many of these large plans back in surplus and fully sustainable. The boards of these plans have approached their various funding issues in different ways, but they have found affordable and sustainable solutions. These models have allowed for direct and consistent member and employer representation at trustee tables, and have empowered the plan's trustees to examine a full range of solutions to the various issues these plans face.

The government proposes a highly prescriptive approach to target benefit plan design that will upset this traditional – and appropriate – balancing of risk and governance. While plan members will bear the risk in a TB plan, they would not have a proportional say in plan governance under the models proposed by government. The discussion paper contemplates requiring a hard ceiling on contribution rates, which effectively removes the most important plan design lever from the trustees' or bargaining parties' influence. Furthermore the paper proposes either agreed-upon or legislated funding surplus or deficit plans that would involve automatic prescripted trigger points and required actions. This would again remove a significant scope of decision-making ability from the trustees or bargaining parties. There is no evidence that such prescription is necessary, as Canadian jointly-sponsored plans have remained on strong financial footing, and have attracted attention from around the world for their success. There is no reason why rigid contribution caps are necessary or useful for a plan. There is also no reason why parties or governments can make such decisions today, lock these trigger points and required actions into the plan design, and be confident that these decisions will continue to be appropriate in perpetuity, since economic circumstances, demographics and the priorities of stakeholders will, of course, continue to change and evolve.

DB plans are sustainable

The results of these negotiations and improved market conditions is that DB plans are returning to health, with full funding again in sight for many. Many of the country's largest pension funds like Ontario Teachers, and the Healthcare of Ontario Pension Plan have actually returned to surplus already. Pension surveys from Aon Hewitt, Mercer and RBC demonstrate what we've seen at bargaining tables across the country: DB plans are not broken and they're returning to health.[3] The notion that DB plans are inherently unsustainable is not substantiated by the evidence. If anything, the fact that plans are on such a strong path to recovery just a few short years after the largest financial crisis in 80 years, demonstrates that the DB model is resilient, and that bargaining agents and plan members want some of the same things as employers: pension plans that are affordable and sustainable for both sides. CUPE recognizes that there are pressures on DB plans, including increased life spans of plan members and a period of historically low interest rates. However, we dispute the argument that these trends mean that DB plans no longer work. They may mean DB plans are costlier than before, which may lead bargaining parties to consider the costs and benefits of the plan and if they feel some changes are justified – which CUPE has been doing across the country.

To abandon a time-tested model based on a one-sided, misleading point-in-time analysis will do more to damage our pension system in Canada. Our defined benefit plans are well-managed and their resilience throughout the financial crisis has attracted the attention of the world – *The Economist* called these plans "maple revolutionaries" and said "Canadian pensions are primed to do well in these dismal times."[4]

Conclusion

Again, CUPE fully endorses the submission of the Canadian Labour Congress to this consultation. We share their view that this process is not about improving the prospects of pensioned or pension-less workers, but about attacking the retirement security of defined benefit plan members expressly to the advantage of their current or former employers. We reject the notion that Canada's retirement security system will be improved by offloading risk entirely from employers to plan members. We reject the notion that we are a society that chooses which contracts it wants to honour, and which contracts can be broken because of political expediency at a particular moment in economic history. We reject the notion that vulnerable seniors, who cannot supplement their income, should see longstanding promises ripped out from under them. We reject the government's efforts thus far to paper over the significance of what it is truly proposing in these changes and will make every effort to ensure that plan members and the public understands the magnitude of the changes proposed in this discussion paper if they are pursued legislatively.

If the government truly wanted to improve the prospects of those without pensions, the only real solution continues to await their approval: CPP expansion. Until then, CUPE will continue to fight for a decent and secure retirements for all Canadians: through a restored age of retirement of 65 for OAS-GIS, through CPP expansion, through exposing the ineffectiveness of the PRPP design, and through preserving and expanding decent DB workplace plans.

[3] The Mercer "Pension Health Index" which measures funding health of Canadian pension plans currently stands at 104%, up significantly from just above 70% after the 2008 financial crisis. A pension survey from Aon Hewitt shows similar results.
[4] *The Economist*, "Maple revolutionaries: Canada's public pension funds are changing the deal-making landscape," March 3, 2012.