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CURRENT DEVELOPMENTS IN PENSIONS: CANADA

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1. Impact of state of economy on pensions
   a. Steps by plan sponsors to control funding
   b. Reactions to control of funding or refunds of surplus by plan participants, labour unions and regulatory authorities

2. The continuing pension debate
   a. Inflation protection for private pensions
   b. Coverage
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   d. Disclosure
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MR. JOHN M. CHRISTIE: This morning we want to try to cover two different topics and I have asked each of the speakers to cover one aspect of each. The two major topics are (1) the impact of the state of the economy on funding of private pension plans and (2) the continuing pension debate. This debate has been going on now for 7 or 8 years, and seems to be reaching some conclusions, with the federal parliamentary committee about to start hearings and their report due at the end of this year.

First, the state of the economy obviously has not been as good in the last couple of years as it was in the 4 or 5 years up to that point and a number of plan sponsors have been taking steps to control their payments into pension plans. I have used the word "control", although in most cases control means reduce. However, the plan sponsors don't have a completely free hand in their efforts to reduce contributions and there are various other interested parties who feel they have a say in the matter: the legislators, the plan participants, and very importantly, particularly in British Columbia, the labour unions.

The continuing pension debate has been going on for a considerable period of time. There seems to be a consensus being reached on some of the less important or less expensive issues. One of the major issues still outstanding and hotly debated is the area of inflation protection for private pension plans, particularly the potential costs of inflation protection. Another area where there is still room for debate and discussion and where as yet no consensus has been reached is in the area of coverage. Should there be a major expansion of government pension plans, should there be some form of mandatory minimum pension plan or is the current situation acceptable? I have seen some recent work suggesting that the present system is not as bad as had been thought, if we look at real needs and the question of income maintenance rather than specifically at coverage by private pension plans.

I'd like to finish with several thoughts that have come to mind recently in considering the issues that are being so hotly debated. The first of these is the question of what the basic purpose of legislation is. Should legislation try to ensure an optimum pension plan for everyone? Should we develop the best possible plan which would naturally be the most costly, and then legislate that for everyone? Or should legislation more properly be directed at ensuring some minimum standard pension plan above which there would be freedom for individual employers and labour unions to develop their own plans to meet the perceived needs of their members? Another major concern is the method of inducing change. Is it necessary to compel plan sponsors to change their plans, or is there a way of encouraging change without creating the immediate negative response to any type of compulsion? The discussions that have been taking place in the pension debate to date have been successful in convincing plan sponsors that certain changes should be made. Sponsors are now more willing to make those changes than they were 5 or 10 years ago.

There is also the question of freedom of choice. In a free society, an employer likes to feel that he is free to choose the type of pension plan for himself, for his employees, or for his union membership. Any form of compulsion through legislation would seem to infringe on the individual freedom of choice. However, there is the other point that if people are allowed freedom of choice, they also are responsible for the consequences of their choice, and is society willing to let them suffer the potential consequences of making the wrong choice?

MR. GEOFFREY HORROCKS: The most current development in the pension industry in Canada is the set of 24 proposals released in March, 1983, by the Pension Commission of Manitoba entitled, 'Proposals For Amendments to the Pension Benefits Act', concerning pension reform of the private system. This document has particular significance in its implied intent to hold brief public hearings followed by the introduction of legislation in the current session of parliament. It indicates a sense of urgency in the need to produce some tangible results from the task forces, Royal Commissions and conferences that seem to have been analyzing the problem forever. In contrast, the federal Green Paper, 'Better Pensions for Canadians', was referred to a parliamentary committee which was asked to report its findings and recommendations by December 31, 1983. No doubt their report will set off yet another chain of federal-provincial discussions further delaying any definitive action to correct the well-identified weaknesses in the current system.

One of the implied criticisms of those involved in the pension process is our seeming inability to produce tangible results from the volumes of philosophical studies that have been tabled. It is said in the legal profession that not only should justice be achieved but justice should be seen to be achieved. The parallel surely applies in our profession and the need now is to convert at least some of the evolving solutions into results visible to pension plan members and beneficiaries.

The Pension Commission of Manitoba is to be commended in its approach of identifying 17 of its 24 proposals as changes with little or no cost and which, by inference, could be enacted quickly into law. Let us review some of those proposals which have the closest impact on plan members.

1. Portability

The proposal for improved portability follows closely the recommendations in the federal Green Paper by suggesting that a terminating member should have the following options with respect to his pension credits:

a. Transfer to a locked-in registered pension account,
b. Transfer to the pension plan of a new employer, or
c. Leave the credits in the plan of the present employer.

It is difficult to imagine how these proposals could offend. Their danger lies in drawing the conclusion that the difficult question of portability has been solved. True portability occurs only when the final employer takes responsibility for all years of an employee's service.

2. Compulsory Membership

The Manitoba commission agreed with both the Canadian Association of Pension Supervisory Authorities (CAPSA) proposals for pension reform and the Green Paper in recommending compulsory coverage where a pension plan exists after attainment of minimum age and service requirements, usually age 25 with one or two years service. All agree that coverage should be extended to part-time employees.

3. Surviving Spouse Benefit

Current thinking appears to be universal in accepting the principle that the standard form of pension on retirement should be on the joint and survivor basis with 60% or 66 2/3% continuing to the surviving spouse. The social desirability of protection for surviving spouses would presumably be more frequently satisfied by an automatic joint and survivor benefit rather than an elective option. It is not anticipated that any additional cost is attached to this recommendation since the amount of joint and survivor benefit would be the actuarial equivalent of the normal form of pension.

4. Disclosure

Both Quebec and Ontario have disclosure legislation requiring basic information to be available on request and also to provide each member, on a regular basis, with an individual benefit statement. The CAPSA and Manitoba proposals extend the benefit statement requirement to an annual frequency.

The Manitoba paper also addressed the two issues of major concern which cannot be categorized as having little or no cost, namely:

- Benefits on termination of employment, and
- Inflation protection.

Benefits on Termination of Employment

The Manitoba paper follows the Green Paper in recommending vesting after two years of service. We appear to have adopted the deferred wage concept and its logical implication of full immediate vesting with the concession to two years being simply a means to avoid the administrative nightmare of a shorter vesting period. The shorter vesting period is a means of locking-in of benefits lending strength to the objective of pension portability.

Of more importance is the recognition at last of the employer's obligation regarding vesting by requiring the employer to bear at least 50% of the cost of the vested benefit.

A recommendation of great visibility to plan members concerns the rate of interest credited to member contributions. Those consultants who have participated in employee meetings will recognize this point to be the one of greatest interest to members and the one to provide the loudest complaints against the pension program. Because of the reluctance of many sponsors to voluntarily credit reasonable interest to employee contributions, it apparently becomes necessary to legislate a rate at least equal to some market rate related to government bond yields or to bank non-chequing savings account rates.

Inflation Protection for Private Pensions

In the realm of public perception of pension plan deficiencies, there is little doubt that the most serious shortcoming lies in the assumed inability of the private sector pension to maintain adequacy in the event of post-retirement inflation.

The background arguments assembled are:

a. Government sponsored benefits are fully indexed to the Consumer Price Index (CPI).

b. Is the CPI a valid measure of the need for indexing, bearing in mind the deficiencies in the index itself and the presumed decreasing needs of the retired population?

c. Pension plans for government employees usually provide for a generous level of indexing with often the suggestion that the indexing is 'funded' by additional member contributions.

d. Notwithstanding the argument in c., the general belief in the private sector is that guaranteed indexing comes at a prohibitive cost.

e. The proud record of responsible sponsors in granting ad hoc increases to pensioners on a regular basis.

The excess interest approach proposed by CAPSA and incorporated in the federal Green Paper would require sponsors to increase benefits to members by the difference between a guide rate (a five year average of long term government bond rates in the Green Paper) and a base rate set at 3½% as an assumed real rate of return, free of inflation. In order to prevent massive unfunded liabilities, the base rate would be 7% for benefits accrued prior to the date of change.

There has been considerable opposition voiced at this concept by consultants and actuaries, usually for the following reasons:

a. The actuary would practically be required to use a valuation interest assumption of 3½%, thereby driving up pension funding costs and deferring the establishment of new plans.

b. It penalizes the employer who has established a generous plan by requiring him to further supplement the benefit level. The employer with no plan has no further responsibility.

c. There would be a flight to defined contribution plans to avoid direct influence of excess interest.

d. Sponsors would rush out to purchase pensioner liabilities to avoid future indexing. The Green Paper acknowledges this possibility by suggesting that indexing may be required on annuities purchased after the publication of their paper.

The arguments are based on technical objections to the excess interest approach and perhaps too little has been said about the social and philosophical validity of excess interest. It is fashionable now to concur that pensions are deferred wages, and indeed in discussing vesting and termination benefits, the argument is strong. I would question, however, that the indexation of pensions after retirement can be considered as deferred compensation, but more as a benefit dependent on the needs at the time and the ability of the plan sponsor to pay.
Is there a proven need to legislate future indexing into the private system? I suggest not. The problems today are magnified by the publicity given to the retirees of the 50's and 60's whose plight is severe due to the lack of Canada/Quebec Pension Plan (C/QPP) at their retirement, the lack of opportunity to accumulate personal retirement funds on a favourable tax basis and the ineffectiveness of the private pension system because of inadequate benefits and insufficient coverage. In Canada we have the opportunity to alleviate these problems through the Guaranteed Income Supplement (GIS) and increases should be made in this program as the needs dictate.

The retiree of the future will be quite different. He will benefit from a mature C/QPP in addition to his Old Age Security (OAS), plus a second OAS if there is a spouse. His employment pension when added to these government benefits will provide a significant replacement income for the average wage earner. After taking account of the full indexation of government benefits, one can justifiably question the need for guaranteed indexation of the private plan.

The approach I favour is that directed towards positive visible action seen to be of benefit to plan members. In the area of excess interest, to which we seem to be moving rapidly, I urge caution and seek further study. There must be a better way. If we are concerned with potential abuses of surplus by plan sponsors, let us direct our ingenuity to a solution to that problem rather than rushing into legislation which might adversely affect the smooth operations of 80% of the registered private plans for the possible benefit of members of a small sector of plans whose sponsors do not act responsibly.

Control of Funding

In the depressed economic conditions of 1981 and 1982, some employers looked to the pension plan as a means of diverting funds from pension contributions to service debt obligations and other pressing financial needs.

The techniques used generally fall under the following headings:

1. Valuation of Liabilities

   Increasing interest rates encourage plan sponsors to take a more optimistic view of the long term return expected from the pension fund and therefore to request the actuary to reflect this optimism in his funding assumptions. Consequently, one has seen a move from the typical 5½% to 6% assumption of recent years to a current level in the range of 6½% to 7%.

   In agreeing to weaken the interest assumption, the actuary will also subject all other assumptions to review. In this connection, an interesting byproduct of our economic difficulties has been a move by many employers to reduce costs by reducing staff numbers. This may be accomplished at the higher ages by offering incentives for early retirement such as a reduced or eliminated actuarial reduction plus supplementary bridge benefits payable until normal retirement age. Any savings realized by weaker actuarial assumptions may well be fully utilized by additional liabilities incurred for early retirement.

2. Purchase of Pensioner Liabilities

   Many a plan sponsor believes that in times of high interest rates and favourable annuity purchase rates, he may capture a profit for the fund by purchasing the pensioner liabilities. In effect, of course, he is only capitalizing the present value of future gains which nonetheless reduces his accrued liabilities and may well assist current cash flow problems.

3. Payment of Expenses From Fund

   Though not normally an item of major significance, there has been considerable interest in charging normal operating costs of the plan directly to the pension fund shown by sponsors.

4. Withdrawal of Surplus From Fund

   In those jurisdictions where withdrawal of surplus is permitted, the rules in at least 2 provinces have been tightened to allow only surplus in excess of 125% of liabilities to be withdrawn.

5. Plan Termination

   A sponsor may choose to terminate a plan completely, thereby eliminating the ongoing costs and, if the plan so permits, receive

the surplus realized by liquidating the plan assets after purchasing the benefits accrued to plan members.

Paradoxically, the control of funding problems we are facing today seem to be with sponsors looking for ways to rationalize surpluses from the improvements in capital markets in 1982 and 1983. The control of funding on the down side may be a non-issue at the moment.

I could summarize my comments by suggesting that the eye of the pension industry is on us to produce some meaningful changes in the system, particularly in the areas of portability and vesting, spouses' benefits and disclosure. I urge caution before making any open-ended commitments to the excess interest concept for indexation.

MR. L. JACQUES PELLETIER: Let me start my remarks on a sour note. Of all major governments in Canada, the government of British Columbia is the least cooperative to the well-being of Canadian pension actuaries. Fortunately, the federal government, Quebec, Ontario, Manitoba, Alberta and Saskatchewan are most helpful. You see, while B.C. has no pension legislation -- I should say not yet ... we should keep hoping -- there seems to be a profound desire on the part of our governments to keep us alive and in good health through the passage of more and more complex pieces of legislation differing from province to province and nowhere in sight can we really see an end to it. In fact, it is catching momentum.

Pensions in Canada are a red hot subject and much 'progress' has been made in the past 5 or 6 years, since the Quebec Cofirentes report. Numerous reports have been written and events have taken place, shedding more light on the problems and solutions of our pension system:

- the Lazar report,
- the National Pension Conference of 1981, and
- the federal Green Paper, 'Better Pensions for Canadians'

at the federal level. At the provincial level,

- the Haley Report in Ontario,
- the report of the Ontario Select Committee on Pensions (early 1982), and
- B.C.'s report, 'Developing a Pension Policy for the Future', issued a year ago.

Also, in 1981, CAPSA issued its so-called 'consensus paper' aimed apparently at the development of uniform legislation on pensions. Since then, some provinces have indicated intentions to go in different directions, and some have even introduced or passed laws that will make it more difficult to achieve uniformity.

A major difficulty encountered by plan sponsors and actuaries is the lack of uniformity in pension legislation. I will illustrate my point of view in two specific areas: first, those of disclosure requirements and, second, the way pension authorities view their role on matters of pension plan funding and surplus distribution. Finally, I shall touch briefly on two still very cloudy subjects:

- Tax changes promised by the federal government, and
- Cost impact of the Green Paper's proposed reforms.

Disclosure

Disclosure is one of my favourite subjects. I often see myself as being in the communications business if not the printing business itself. Most actuarial firms produce benefit statements and thus we should selfishly endorse any legislation which requires complex information to be divulged to plan members in the most understandable manner possible.

I also believe that information to pension plan members enhances appreciation of the plan itself and facilitates sound advance retirement planning. Extensive, though different, disclosure requirements now exist in Quebec, Ontario and Saskatchewan. CAPSA, as a follow-up to the consensus paper, has prepared specific recommendations with respect to disclosure and Manitoba has included these in its proposal. The major difference between CAPSA proposals and, say, Quebec's and Ontario's is that annual statements - as opposed to triennial - would now be required.

Briefly stated, existing and proposed legislation require that the plan member:

1. Has a right to get adequate information about plan provisions including amendments.

2. Will receive annually a statement allowing him to determine where he stands with respect to accrued benefits, contributions, retirement, death and termination entitlements.

3. Will receive annually a statement of the plan's funding ratio on an ongoing basis.

4. Will have access, on request once a year, to full plan provisions, actuarial reports, cost certificates, financial statements, list of assets, correspondence, etc.

As mentioned earlier, the majority of the proposals are already in the legislation of either Quebec, Ontario or Saskatchewan. The task of arriving at a consensus here was simple: everything already in place in any province was taken and a few goodies were added. Except for a few points, I am not negative about this legislation. To the extent that employees know more, they will understand better and it should help our private system of pensions to continue and flourish.

Having paid my dues to the positive aspects of the legislation, I will concentrate on some negative properties of existing, proposed or feared legislation with respect to disclosure:

1. Sufficient detail is good; too many details get in the way of adequate information. I fear that in some respects the requirements will lead to an excessive amount of information reducing proportionately the interest of the average plan member in the pension plan.

2. In some instances, the information to be given requires expert knowledge of the subject and thus may generate more confusion than information.

   I shall refer here, as an example, to the 'funding ratio' of the plan on an on-going basis. In fact, this particular requirement has to be of prime concern to actuaries. As you know, you can have two different pension plans with identical benefits covering exactly the same employee profile and with the same assets and yet obtain two different funding ratios -- even if both plans used the same actuary -- simply because different valuation methods are used. It doesn't make sense to any of us to have employee statements show two different funding ratios simply because two employers choose different funding patterns. Clearly, the highest figure does not reflect a higher security of benefits, at least viewed prospectively. But this is what we have today in Quebec's legislation and this is what CAPSA proposes.

3. The disclosure requirements should be there to inform, not to mislead. I do not agree that showing the first age at which an employee can retire without actuarial reduction - this is one of the requirements proposed by the consensus - is useful or adequate information per se. In fact, the best information should be the age at which the employee would receive the greatest (dollar or percentage?) subsidy by retiring. As a substitute for this proposed misleading age requirement, I would like to suggest that the employee statement should show:

   - at what age the employer can first retire, and
   - what price he will have to pay for this privilege, if any.

4. The cost-effectiveness of the requirements should be studied and justified. For example, in industries where work is cyclical in nature and where employees often change employers, as in a multi--employer plan, one can easily visualize situations where the bulk of the plan administrator's work is to produce termination statements; the ex-employees, when you can find them, will not understand the purpose of this forest destruction process and if they understand, may not care. Clearly, accommodations have to be made to prevent such excesses.

5. Finally, disclosure requirements to pension plan members should not become a tool by which employees could legally paralyze the operations of the employer. The requirement to make available to plan members, once a year, pages and pages of documents could certainly create serious administrative difficulties if misused by plan members.

Thus, in conclusion, I tend to agree with meaningful expanded requirements regarding disclosure, but I would like them to be uniform, really uniform, and would prefer the present proposals and legislation to be further polished.

Surplus Distribution

You are aware that we have recently gone through difficult economic times; some people think that we are not through such times yet. It should not be a surprise to anyone that employers struggling to keep their company alive will consult their actuary to see if they can reduce their contributions to the plan, either by funding less conservatively or by using the surplus in the fund, if any. In some instances, employers go so far as to ask for a cash refund of the surplus in the fund. To the best of my knowledge, government authorities have accepted less conservative valuation assumptions or methods, provided the actuary was prepared to stand behind his choice of method or assumption. It's no secret that most pension plans in Canada are funded conservatively and thus are often in a good surplus position. They are so funded for numerous good reasons:

- protection of plan members
- pre-funding, to some extent, of future benefit improvements
- stability of contributions
- etc.

As a rule, it is better to have a good job than a good pension plan, and I, for one, have done my best to ease an employer's financial situation whenever conditions permitted to do so. One way of achieving it is to use economic assumptions which reflect current market conditions as at the valuation date. For example, in the past few years there was no big risk for the actuary in anticipating a 12% return on the invested assets of a pension plan, at least for the short term. I have used variable assumptions which would start, say, at 12% initially, and then decrease gradually to 6% after 10 or 12 years. Provided all assumptions and the value placed on the assets were consistent, this clearly provided relief in numerous instances without jeopardizing the security of benefits. As far as I know, this use of assumptions 'closer to reality' has been accepted by all pension supervisory authorities. Employers could thus use part of their surplus to take a contribution holiday without having to resort to the purchase of annuities.

Of course, the purchase of immediate annuities has also been used to a large extent, and insurance companies and their brokers have sometimes been seen as magicians who could do what the pension actuary could not achieve. Bond immunization is another technique which, to the best of my knowledge, has been widely accepted by supervisory authorities.

Refunds of surplus have generally been viewed differently. While the federal Department of National Revenue (DNR) is all in favour of this since a refund of surplus effectively transforms tax-exempt money back into taxable income, the Quebec Pension Board seems to be of the opinion that, unless the plan text clearly states that surpluses belong to the employer, they are plan participants' property. It is difficult to rationalize Quebec's position on the refund of surplus if, on the other hand, they accept that the employer could take an indefinite contribution holiday for an equivalent amount. However, exceptions have been made. The other provinces seem to have a view opposite to Quebec's. If the plan text is silent, surplus belongs to the plan sponsor. In its proposed legislation, Manitoba will apparently take a midway approach; they would like to see surpluses shared by plan participants and plan sponsors on the basis of contributions made to the plan by each party.

Essentially, the same principles apply on plan termination and it may lead to very interesting situations. Take, for example:

A. An employer has a generous final pay plan funded conservatively using the entry age normal valuation method with salaries projected to retirement. The employees contribute 5% of their pensionable earnings and on death, withdrawal or termination of the plan receive, as a minimum guarantee, the value of their contributions with interest at the fund's earnings rate.

Let's assume the employer has to terminate the plan. If he is in Quebec, all surpluses belong to the participant to the extent that they do not buy benefits in excess of the DNR maximums. If he is in Ontario, all surpluses can go back to the employer. It is not clear what would happen under the proposed Manitoba legislation, but the proposals recommend that surpluses be ratioed between employees and employers on the basis of contributions.

It seems to me that a refund of surplus to the employer is the most logical solution here.

B. Another employer, on the other hand, has a modest career pay plan with employees contributing 5% of pay, funded on a unit credit method. Employee contributions are accumulated at 4% for benefit calculation purposes. If that plan is terminated, it may very well happen that the surplus will exceed the contributions made by the employer. It does not seem reasonable to return to the employer surplus which originated from the employee's contributions.

C. A third and more interesting example has been recently brought to my attention.

An employer has a final pay plan which he wants to terminate to enter into a new money purchase type of agreement with his employees. The fund is in a surplus position of about 30% and the employer prefers to leave this money in the fund for the participants. However, he would like to distribute the funds in proportion to the projected benefits for the credited service to date instead of the accrued benefits. His rationale is that employees age 64 have obtained more or less what they could anticipate as a benefit, while younger employees will suffer a much greater loss. Unfortunately, it does not seem possible to do so because surpluses have to be distributed in accordance with accrued pension credits. Thus, everybody will get the same percentage increase.

Tax Changes

The Green Paper has promised that a proposal for reforms regarding tax assistance vis a vis pension contributions - employer or employee - would soon be tabled for discussion. Unfortunately, at this point we have not yet seen anything and nobody seems to know when this proposal for a reform will be presented.

What we know for sure, and it is acknowledged by the Green Paper, is that the present system is not equitable.

On the plan member side:

a. if he does not belong to a registered pension plan (RPP), he can contribute up to $5,500 a year.

b. if he belongs to a contributory RPP, he can contribute up to $3,500 a year to a registered retirement savings plan (RRSP) and the RPP.

c. if he belongs to a non-contributory RPP, he can contribute up to $10,500 over two years through the flip-flop (RRSP and RPP) process.

d. if he belongs to an RPP, he can also contribute for past service years of membership for which no contributions had been made, up to $3,500 for each past year.

On the employer side:

a. he cannot contribute in the names of his employees unless he has a formal registered pension plan.

b. if the plan is a money purchase plan, he can put in $3,500 per year.

c. if the plan is a defined benefit plan, the maximum amount is controlled by the maximum benefit amounts set out by the DNR regulations. Depending on the employee's age, funding method, etc., the maximum contribution can be as low as $1,000 or go as high as $25,000 or more in a year.

   What is certain is that through the defined benefit approach one could accumulate roughly $900,000 of employer money to provide for a pension benefit, while one could probably accumulate a maximum of $400,000 to $500,000 under a money purchase arrangement.

The present limits have existed since 1976 and have thus lost more than 50% of their value in real terms. The $60,000 maximum pension ceiling has existed since 1976, if my memory is right. I assume that the need for more government revenue has prevented an adjustment in these limits and one can hardly visualize the government willing to add a further $3 or $4 billion to its projected $30 billion deficit.

Other complexities of the present system could be mentioned, such as the treatment of deferred profit sharing plan (DPSP) contributions, but they will merely serve to confirm the urgency for reform. If we accept that the rationale behind tax assistance is to encourage savings for retirement, clearly all vehicles used to achieve this purpose should be given equal tax treatment. There are problems, however, and the most important one is that tax assistance reduces the government's revenue and obviously the government could not in one simple shot increase the maximums. It will have to be gradual.

Some students of the problem have suggested that, for purposes of establishing the maximum amount eligible for tax assistance, all

contributions - employer or employee - should be treated alike. Thus each eligible dollar of contribution not made by the employer could be contributed by the employee instead, and be tax deductible. It would become irrelevant whether the money goes to an RRSP or to an RPP, as regular or voluntary contributions, or paid for by the employer or by the employee. Conceptually it is very simple and should meet tests of equity very easily.

What would remain to be solved, however, is how the maximum allowed in any given year would be determined. For example, would it be a fixed dollar amount or an increasing amount, as it is now in fact for employer contributions in many defined benefit plans? One alternative might be to have for each year a fixed dollar amount maximum, with carry over provisions for any unused portion in a given year.

One approach which is being considered is one whereby the objective would be to accumulate by a chosen retirement age, say 60 or 65, a sum sufficient to provide for a pension representing X% (say 70%) of the employee's earnings or average earnings at retirement. Based on an employee's earnings at a given age and this benefit objective, the fund should then have attained a certain target amount; the deductible amount in that year would then be the difference between the target amount and the sum of all credits accumulated to date from all sources.

This is a very straightforward approach which would require to start with:

a. establishing the overall maximum pension benefit both in dollars and a percentage of earnings,
b. determining funding targets along the road, and
c. finding administrative facilities to compute the deductible amount and report it.

Since tax assistance is such an intrinsic part of pension reform, we need to see soon a paper on the subject. So let us keep our fingers crossed.

Cost Impact

Finally, I want to make a few comments on the cost impact of pension reforms proposed by the Green Paper.

The figures shown by the Green Paper seem to indicate that the cost of the reform is not that great; an overall percentage of about 2% of earnings would apparently do the job. You have to multiply this percentage by total expected payroll to get excited about it. However, the Green Paper shows clearly that costs will be different from plan to plan and that in many cases, the good guys, i.e. the employers with the most generous pension plans, will finish last.

The federal government has indicated that the technical papers supporting the Green Paper including the cost illustrations will soon be made public. We should then be in a position to better assess the reasonableness of the Green Paper cost figures. From the detail of the assumptions used, it will be possible to relate these costs with those presented in other reports and which seem to indicate much higher costs.

I should say also that the Business Committee on Pension Policy, which groups about 10 major associations of the private sector, has undertaken a major study, with the assistance of a well-known and respected actuarial firm, which aims at identifying as clearly as possible the real costs of the proposals.

A few things are important to remember, however:

- even without reform, our present retirement security system is going to cost much more. The contributions to the C/QPP will have to grow considerably to pay for the benefits.

- costs in themselves, whatever their size, will not prevent the reform from happening. They may impose a slower phasing-in process than planned originally, but nothing more. If the need is there, there has to be a way to fulfill it.

Thus, our professional contribution to the pension reform process must not be restricted to costings; it is far more important to participate in careful analyses of the real needs, as opposed to perceived needs, so that we do not end up paying for a system which is excessive in some areas and still deficient in others.

Conclusion

Pensions are under provincial legislation and there is tremendous political pressure to effect some needed change. However, the subject will be discussed at the national level for the next 6 - 8 months and, hopefully, recommendations will meet with the majority of provincial objectives. I would hope that provinces will wait before introducing new changes. The ideal would be that when a real consensus has been reached all provinces, including B.C., will introduce their legislation in a relatively short period of time.

MR. BRUCE ROLLICK: I have been asked to comment on four topics in a relatively short time and I find that in going over my thoughts, I could spend the allocated time on any one of these topics. Let me give you the topics:

1. Reactions to control of funding or refunds of surplus by plan participants and labour unions

2. Coverage

3. Expansion of public plans

4. Special concerns of multi-employer plans

Reaction of control of funding and refund surplus

One area that is very interesting and I will discuss at some length is the reaction to control of funding and refund of surplus, but from a little different point of view than has been already presented. I've gotten into this in a large way through the legal aspects as much as the provincial funding requirements.

I view this area as being a powderkeg with big problems. Some of these problems were foisted upon us years ago by DNR who required it be written into a plan that, on its termination, funds could never return to the employer. That is, the plan had to be an irrevocable trust. In recent years, DNR seems to have changed its mind. What someone didn't tell them is they don't have the power to change trust law in the various provinces. As a result, a large number of employers have problems that they either haven't faced or that they have dealt with illegally.

There are two very good cases on this subject involving employers who had a plan where the plan provided that, on its termination, no surplus could be refunded to the employer. One of them is in B.C. and it's called the Cantol case. The other is in Ontario and I unfortunately don't remember the name.

In the Cantol case, the employer had a non-contributory pension plan which had a provision that said surplus could not be returned to the employer. The employer attempted, simultaneous with its termination, to amend the plan to alter that provision to say that, beyond meeting its obligations, they could remove the money. They then proceeded to have the trustee pay out enough money to meet the obligations to the active members. When they then asked the trustee to pay out the balance of the money to the company, the trustee refused to do so and forced this issue into court. What is interesting is the Court's interpretation. The Court ruled that the company's amendment of the plan was illegal. It was null and void; it could not be done. But then the Court ruled that on the theory of resulting trust, which I don't quite understand, the company could get back the money. I don't know where that puts us as a profession. The lawyers cannot explain to me the logic of this process but I suspect if there had been employees involved in this situation, there could have been yet a further interpretation. In any event, it's a very interesting case and it's one to be aware of, particularly if you're talking to an employer who is thinking of changing his plan to alter that particular provision. In the Ontario case, as I understand it, the same exercise was proceeded with and the employees challenged the amendment and successfully had all the money distributed to the employees. My experience with this, as it relates to unions and participants, is that participants are generally not aware of the trust law implications that are inherent in many of these pension plans. I suspect, however, as they become more aware, perhaps through disclosure requirements, the ability of the employers to get money out of a plan on plan termination will be reduced to almost nil, unless that clause is clearly written in the plan from the day the plan started. If you've tried to amend the plan, I suspect you've broken the law. A competent trust lawyer may tell you that you can write the amendment, but if it is ever challenged, it may be deemed to be null and void.

As far as unions are concerned, I have never found a union agreeable to the idea that money be paid to an employer on any basis. Their reaction is obviously pretty negative to that whole process.

Some of the other speakers this morning have commented on the concept of removing surplus from a plan while it is on-going. My experience is similar to theirs that in those jurisdictions where it could be done, the rules have now been tightened up so much that it is almost a waste of time to think about a direct refund of money.

There have also been some interesting developments lately regarding registration by DNR. Years ago, pension plans had to have the condition that money from a pension fund could never go back to the employer. In recent years, we have gotten requests in writing from DNR that we must now change this or face deregistration. I suspect many of you in the consulting business have received similar requests. For what it's worth, we have gotten a letter from DNR in which they admitted that request is illegal. So if you want to challenge DNR, feel free to do so. DNR acknowledges that they can't make that request, regardless of whether it is in connection with a past service application or not.

Negotiated Plans

Some other interesting items have developed recently concerning negotiated plans. DNR has attempted for years to force us to put the maximum benefit rules into negotiated plans. I have consistently resisted them. In fact, even if I put the rules in, I question what good it would be if the plan terminated. I have asked DNR what happens if the plan terminates and it has a surplus. The money cannot go to anybody but the employees. DNR admits that, but just won't give me an answer. They said they'd like to see the rule anyway. So again it's just a big problem sitting out there waiting to be resolved.

Another interesting point has arisen. DNR has informed us by letter that the maximum benefit rules are unnecessary in a negotiated pension plan, as long as the contribution does not go over $3,500 per person and an application for special payment has not been made. This is not part of their published rules. Most plans will be able to satisfy that requirement but we have a negotiated plan where the contribution is over $3,500 per employee. I cannot believe that DNR is going to say to that union that it can't have the same rights as other unions. In other words, because the union has done a good job for its members and raised the contribution rate high enough that the plan can almost grant an adequate pension, DNR is going to penalize it. I can't see how DNR is ever going to hold their position on that situation. This leads to a corollary as soon as the maximum benefit rules are lifted and that is that DNR will allow plan members to have benefits that exceed the maximums. How is DNR ever going to apply their maximum benefit rules to anybody? DNR cannot have a dual system of rules that says one group of the population can be better off than another. I almost view this as a commencement of the collapse of this whole system of rules that we've had to date.

Unfunded Liabilities and Plan Termination

We have recently come across some other interesting things involving Pension Benefits Act personnel. Saskatchewan has told me that they think under their Act they can force an employer to fund unfunded liabilities on plan termination. I don't believe they can do this. What will happen, if they make employers liable for payment of unfunded liabilities on an employer by employer basis, is that employers are just not going to provide past service benefits. That's going to substantially slow down the delivery of benefits. It's a very foolish position for the province to take, but we have had at least one province tell us that they think they have the power under their existing Act to do it. The particular employer and union involved are resisting.

I've also got another example of a union that's attempting to negotiate a collective agreement with an employer whereby the employer would be liable under the collective agreement to pay any unfunded liabilities. I've never seen one of those before. I wish them luck, but they may get it.

Now in summary, my experience in this area says a number of things. One is that actuaries have been perhaps guilty, from time to time, of illegally practising law and forgiving themselves on the basis that there was no loss of equity. That may be a reasonable defence on a short-term basis, but it's a dangerous one on a long-term basis. We have argued that we can do things with these pension trusts, move money back and forth and transfer from one plan to another. As long as nobody is hurt, it's all OK. We're skating on very thin ice with that viewpoint. We've really got to start to work closer with the legal profession in this area to build a better legal basis for the items that are sensible. It's not that we are asking to do things that are not sensible, but they are just not legal at the moment.

I also suggest that we should not accept without challenge rules and regulations that are promulgated by DNR or the provinces without the appropriate legal authority. The biggest problem with the provinces is a government mandarin who is well-meaning enough but who does not bother to think about the fact that they've got labour law and trust law legislation in that province. There is a large issue as to what takes precedence when pension benefit legislation is in direct conflict with trust law. Maybe we need some common law, but this area is going to develop so slowly that we as consultants are going to be making decisions, giving advice, helping clients do things well before we have any common law to rely on.

Coverage

The next subject I would like to comment on is coverage. Certainly a large part of the material we've seen to date about the problems of our system claims that not enough people are covered. Some of the coverage figures in the government reports and some of the other reports need to be challenged. One of the items that B.C. put in its Discussion Paper was a good analysis of coverage problems. Maybe the employees in B.C. have better coverage than in general, but the analysis applies to more than just B.C. The paper gave a good argument for the fact that coverage problems are not nearly as serious as the federal government led us to believe in its reports.

If employers and the business community as a whole are forced to live with greater coverage proposals, there is going to be a significant cost, particularly when these coverage issues are combined with the proposals that are being put forward for rapid vesting and indexing of vested benefits. Some of these ideas are developed by people who have never seen a high turnover multi-employer pension plan. They are almost unworkable. You can burn up more money in administrative costs than you are giving in value to the employees. The coverage issue and the idea that everybody should be in the plan almost from day one, without regard to the kind of business or industry, is not very realistic.

There is going to be a great deal of resistance by employees to full coverage, particularly in a contributory program. It is asking people to

start making contributions of fairly significant amounts, quite often, at a time in life when that's not what they want to be doing with their money. They want to buy their house, pay for their car, and many other things.

Coverage is not the most important problem we have to solve. Once we have some of the other areas solved, such as what's going to be the interrelationship of the private and public systems, the coverage issue will work itself out much more easily.

Expansion of the Public Plans

The third topic that I was asked to give a few comments on was expansion of the public plans. I was pleased to read in the federal Green Paper that they are rejecting that idea. I just don't trust them. I have this feeling that they are saying to us, "We've warned you. Do your thing, but if you don't do it within about three years, we'll have an excuse."

There is a need to coordinate the government programs. We have three of them now with GIS, OAS and C/QPP. There is a need for a rationalization of the delivery of what amounts to retirement income. I was a bit disappointed that there was not some attempt made in the Green Paper to coordinate C/QPP and OAS. There would be logic in doing that.

I hope out of this process there will be some room left for the private pension system. I would like to think that we live in a free society and I'm still a believer in capitalism and that they'll retain the private pension system. But we as consultants, the people who are the payers, the employers, and the local unions have got to continue the process of making the private system a better one.

For anybody who wants to read an interesting article, the Canadian Labour Congress has made a submission to the federal government. One of the things that they say, and I had a hard time rejecting, is there is no cost at all in publicly provided retirement income. All these actuaries say it costs, but that's a lie. All that happens is we're going to just shift things a little bit, but there's no cost; we're not removing anything from the whole system. We're going to take a little bit of money out of young people's hands and put some of it in savings and some of it into retired people's hands. Now that means we're going to perhaps have less consumption power amongst the younger group and more amongst the retired. In the short run, we're also going to put some money away and invest it, which perhaps will help the economy. In the long run, however, it will have the reverse affect. If we don't begin to solve the problem, it makes the necessary shift larger in order to achieve benefit adequacy. In the long run, we will have more consumptive capacity, because we won't have to take such large chunks of money from the younger people, since money had already been put aside. It's not a bad argument and I'm not sure it's not even right. When you get down to that, unfortunately though, the best way is probably the federal government system. I really hope there is no one here from the government listening, because I really don't think that's the proper way to go, but there is something to their argument.

The unions have clearly spoken out for improving the federal program and they have obvious reasons. One is that it would remove the need for them

to negotiate retirement benefits at the bargaining table. This position of labour seems to be at the national level. Many local unions, however, don't like that approach at all. They want to be able to deliver benefits to their people that reflect the nature of their union and the industry they are in.

My fond wish is that we will see a sensible reassessment of government plans. We will undoubtedly see some expansion of these programs. I hope the expansion takes place after they rationalize these various programs rather than before and that there will, down the road, still be a place for the private pension system.

Negotiated Multi-Employer Plans

The final topic I was asked to comment on are the special concerns of negotiated multi-employer plans and this is the one area that you could unfortunately write books about. There is very little that I could tell you in a short time that is really interesting. Clearly, without getting into all the various details, these plans have incredibly large problems that have not been addressed at all in the federal government or provincial governments. I'm encouraged to see that Ontario has developed a task force to begin to study these problems, and to rationalize where they're going.

These plans themselves resolve some of the criticisms of the system such as the lack of portability. Certainly, this is true if we could ever work out systems for transferability across union lines. Many unions have already got portability across the country. The plumbers and bricklayers have it; a plumber can go from coast to coast and participate in a program having his pension credits move with him.

These multi-employer plans, as any of you who have dealt with them are aware, do have special characteristics. There are going to be large problems if funding guarantees are imposed upon them such as they have in the United States. DNR has attempted from time to time to be flexible, but there are many problems regarding these plans that DNR just hasn't contemplated. For example, they view all pension benefits as relating to employment, and yet most negotiated plans provide for pension and service credits based upon factors other than employment, such as union membership. There can also be large periods of time when a member is not working at all and yet he can still be receiving pension credits under this program, provided the rules that have developed are followed.

Yet another aspect of these plans is the fact that because they are industry-wide, they have much financial stability. In other words, the funding of these plans doesn't rely on a single employer, but it relies on a whole group of employers, a whole industry. There are problems if the entire industry collapses, but hopefully that happens less often than with a single employer.

MR. COLIN E. SOUTHCOTE-WANT: I'm up from the States and work in Seattle as a pension actuary. I came to this session today for the heck of it. I guess that's what I've got. It is very interesting to see what your challenges and problems are here in Canada. I was starting to feel a little bit cocky, even though the ERISA rules are pretty messy, until the

end when you started talking about multi-employer plans and if you want to see what not to do, look at the United States, because we really have a mess down there.

My question for the panel relates to what the involvement of actuaries has been in this pension debate and what the involvement of actuaries should be. Could you also respond to what the involvement has been and should be of the Canadian Institute of Actuaries (CIA) in the pension debate?

MR. PELLETIER: I know that some of the major firms will participate and make presentations before the parliamentary committee. The CIA as a unit has always been very active in making formal presentations, not only before the federal government with respect to the parliamentary committee and the Green Paper, but to all provincial legislations and to the Manitoba government on the proposed legislation. We've always been very active.

Actuaries have been involved in other capacities as well. I was at one of the sessions as a representative of the Canadian Chamber of Commerce. So, I think we're out there all over the place. I don't know what impact we can have, but we certainly are very active.

MR. HORROCKS: We have been involved and I, like Mr. Pelletier, have appeared before one or two bodies. I always get a little nervous, though, that they're looking at actuaries from a different prospective. They think we can add up the numbers correctly most of the time, but I'm not sure that they're convinced that we have a humanistic social appreciation of the problems.

MR. ROLLICK: I generally agree with the comments that have been made. We have to be more active. We have a problem with believability and that we are a self-interested body in the process of keeping the present system alive. We shouldn't pretend we're not; that is what it amounts to. It would be nice if we had a greater degree of believability, by labour and the government in particular, where we now have a lack of believability.

Clearly we are a body and a group of professionals that has the best opportunity to give some sensible input to this process. But I'm not sure how successful we're going to be in that process.

MR. PELLETIER: I'm deeply concerned. I think we have to contribute. In the first presentations by M. Begin, Minister of Health and Welfare, the main concern was coverage. That 50% figure is so politically powerful that I'm afraid if we don't challenge with accurate figures and solid answers, we're in deep trouble.

MR. DAVID BROWN: Mr. Rollick's comments about the handling of surplus and the amendment of plans were interesting to me. There is a case that is in the courts in Ontario right now, where I think I can say with some certainty, that the actuaries didn't mess it up but the lawyers certainly did. There was a provision in the plan which said that, if the plan terminated, under no circumstances could surplus revert to the employer and that the plan could not be amended in any way that would have any other effect. Then, of course, DNR came along and said that it would

discontinue the registration of the plan unless it was amended in a way which said that the surplus reverting to employees had to be limited by the maximum benefit rule. This amendment was duly put in on top of the others, though when you read through the plan, it doesn't make any sense anymore. The surplus in fact, did not come up to the DNR maximum. All the surplus was distributed to the benefit of the employees, and then the trustees apparently got cold feet. Some of the creditors of the estate put pressure on the trustees and the creditors are now challenging this distribution in court. I think that the obvious culprit in the situation was DNR with its request for an amendment. This is of some concern to any of us who may have thought that, once a plan was terminated, the assets inside the fund were safe from the creditors of the company.

I am going to mention one or two other points. On the question of requiring an employer to continue funding for unfunded liabilities on a terminated plan, that concept was embodied in the amendments to the Ontario legislation in 1980. We have not yet really seen much practical application of it, but it is there potentially and it may have the kinds of effects that Mr. Rollick mentioned. I think the rationale for putting it in in Ontario went hand in hand with the concept of the guarantee fund. I don't know whether very many of us really buy that concept. Once we start to legislate a guarantee fund, then we need to protect the fund itself against the possibility that the employer will not fund the plan in the way that he should or will close down the plan and refuse to recognize the obligations that he originally took. In any event, it's there. I understand that Saskatchewan thinks that they have the same thing. Reading their legislation, I can't totally agree.

In the province of Ontario, there has been some tightening of the rules, but I would disagree with the view that the tightening of the rules has discouraged applications for refund of surplus or in fact of very large amount of surplus being removed in some cases. This has certainly been going on, to perhaps a greater degree than some of us realized. The tightening of the rules may not be finished yet.

MR. GREGORY L. HYATT: I'd like to take exception to one of Mr. Horrocks' comments pertaining to the Pension Commission of Manitoba's proposed legislation. He started off making comments lauding the pension commission for taking the actions they have taken in order to come to some decisions with regard to pension reform. In a country with 10 provinces, especially where one is as small as Manitoba, we have a situation of the tail wagging the dog. Should Manitoba proceed with this very significant pension legislation over the next year or the next few months for that matter, we may find ourselves faced with national employers doing some head scratching in order to redesign their plans in order to have them make sense for all their Canadian employees.

MR. KEITH P. SHARP: This question is directed primarily to Mr. Horrocks. Although no comprehensive survey has been done, my guess would be that only about half the employers with pension plans have given significant ad hoc increases to pensions in payment. The increases which have been given typically offset only about half the rise in the CPI. Would these estimates correspond with your experience?

It would not seem to be a valid argument to say that indexation of private plan pensions is made less necessary by the indexation of government provided pensions. If one argues that indexed government pensions allow private pensions to not be linked to the CPI, then one could slightly extend the argument and say that private plans are not necessary at all.

MR. HORROCKS: We probably have a philosophical disagreement. I feel that the CPI is not a valid measure of increasing costs. A second point is that one's needs decrease after age 65, regarding clothing, housing accommodation, etc. When these two points are combined with full indexing of C/QPP and OAS, one can draw the conclusion that perhaps 50% indexing to the CPI for private pension plans is sufficient for adequacy.