MULTI-EMPLOYER BENEFIT PLAN COUNCIL OF CANADA

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SUBMISSION

OF THE

MULTI-EMPLOYER BENEFIT PLAN COUNCIL OF CANADA (MEBCO)

TO

THE ONTARIO EXPERT COMMISSION ON PENSIONS (OECP)

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SUBMISSION OF THE MULTI-EMPLOYER BENEFIT PLAN COUNCIL OF CANADA (MEBCO) TO THE ONTARIO EXPERT COMMISSION ON PENSIONS (OECP)

September 27, 2007

MEBCO

MEBCO was established in 1992 to represent the interests of all types of Canadian multi-employer benefits plans, including multi-employer pension plans ("MEPPs") and multi-employer benefit plans ('MEBPs"). MEBCO is representative of all persons and disciplines involved in these plans, including union and employer trustees, professional third party administrators, non-profit or "in-house" plan administrators, and chartered accountants. MEBCO is administered by a Board of Directors consisting of representatives from each of these groups. MEBCO is representative of MEPPs that have, on average, 400 participating employers.

MEBCO members have responsibility for administering benefit plans with accumulative membership of workers and families of over 1 million persons in Canada.

Multi-Employer Pension Plans ("MEPPs")

Over the past quarter-century, labour and management joined together to respond to the problems of delivering retirement benefits to workers and their families in industries typified by small companies and a mobile work force. Members of MEPPs work in industries as diverse as building and construction, food, service, retail, hotel and restaurant, graphic arts, garment manufacturing, security, textiles, transportation, and entertainment. A single MEPP may be national, regional, provincial, or local in coverage. Anywhere from two to over 1,000 employers may contribute to one of these plans under collective agreements.

MEPPs provide continuous benefits coverage to workers as they change employment from one contributing employer to another. This portability provides seamless pension coverage, and is essential for workers in mobile or seasonal industries such as construction and entertainment.

A MEPP is typically structured as a pension trust fund for purposes of s. 149(1)(0) of the *Income Tax Act* (the "ITA"). The trustees, appointed pursuant to a trust agreement, are usually responsible for the administration of the plan and the fund. A fund will either handle its own administration or hire of a third party administrator.

Multi-employer defined benefit pension plans based on labour-management negotiations in the private sector are a cornerstone to the provision of retirement income in Canada.[1] Unlike single employer plans (SEPPs), these plans are not being wound up, converted to (or replaced by) defined contribution plans, or subject to wind-up because of the insolvency of a single employer. They are not the subject of disputes about contribution holidays or surplus ownership. Further, the "defined benefit" is in reality a target benefit, because contribution rates typically are fixed in collective agreements.

MEBCO's concerns with respect to Ontario's regulation of defined benefit pension plans include the following issues:

1. Funding requirements, particularly those related to solvency funding
2. Grow-in requirements
3. Adjustments to target benefits
4. Transfer values and other lump sum distributions (including annuity purchases, shortened life expectancy, and small amounts)
5. Suspension of benefits (due to reemployment after retirement)
6. Obligations with respect to a change of bargaining representative
7. Qualification of audited financial statements with respect to employer contributions
8. PBGF coverage
9. Multi-jurisdictional plans
10. Feasability of MEPPs for small employers' non-bargaining employees
11. Regulatory and legislative mandate

Funding Requirements

The primary threat to MEPPs' continued ability to deliver adequate, secure, equitable benefits is, ironically, a provision that is allegedly applicable to MEPPs[2] and that is allegedly for the purpose of providing benefit security – solvency funding. Therefore, one of MEBCO's highest priorities is to eliminate all doubt with respect to this issue by clarifying that solvency funding is not applicable to plans that are registered as Specified Multi-Employer Pension Plans (SMEPPs) under the Income Tax Act.

[1] In rough terms, there are nearly 200 MEPPs in Canada covering over a million participants. About 40% of these plans are registered in Ontario.

[2] This is the view expressed by the Financial Services Commission of Ontario (FSCO). MEBCO disagrees with that interpretation of the funding regulations as they existed prior to September 1, 2007.

Solvency funding is designed to help assure plan participants that their pension benefits will be provided without resort to employer assets – for example, in the case of plan wind-up related to employer insolvency.[3] In the world of SEPPs, solvency may support this public policy goal by requiring higher contributions. If the plan does not wind up, the employer's higher current contributions are offset by lower contributions in future years. The SEPP participants' pensions, however, tend to be unaffected by the timing of the employer contributions.

In the SMEPP context, however, employer contributions are generally fixed for multi-year periods in collective agreements. Therefore, an increased contribution "requirement" cannot be satisfied by increased contributions, because contributions cannot be increased during the term of the agreement. Rather, it must be met by lower benefit levels for participants. Benefits can be raised later, but the plan participants will be different at that time. This creates "intergenerational inequity" – a situation where participants who are similarly situated receive significantly different pensions for no other reason than compliance with solvency funding. That is clearly an undesirable outcome, particularly as it leaves today's pensioners and beneficiaries with potentially inadequate retirement income unnecessarily.

It has been alleged that solvency funding creates a socially desirable outcome, because it increases the likelihood that all pension "promises" will be kept, both in the normal course of a continuing plan and in the unusual case of a plan wind-up. We must note that plan wind-ups are much rarer among SMEPPs than among SEPPs, for the obvious reason that the insolvency or termination of a single employer does not automatically carry with it the wind-up of the plan. Indeed, in many cases such an employer termination has little relevance to the benefit security of that employer's workers, because the multi-employer plan simply continues to operate without change.

On August 27, 2007, the Finance Minister announced modifications to the regulations governing MEPPs. The primary change in the "permanent" portion of the regulation was the clarification that solvency-funding requirements do apply to MEPPs. Until this regulatory change, there were very strong and practical arguments that the Regulations did not impose solvency funding on MEPPs. This regulatory change is therefore potentially a step backwards. However, on a temporary basis the regulation was amended to define a Specified Ontario Multi-Employer Pension Plan ("SOMEPP"). SOMEPPs are temporarily relieved from solvency funding requirements, and are subject to certain modifications in the going-concern funding requirements. Eligibility for the SOMEPP provisions is elective by any eligible MEPP. MEBCO is supportive of this relief from solvency funding, but takes issue with its temporary nature, particularly since the situation at the expiry of the temporary relief would now clearly impose solvency funding on all MEPPs. MEBCO's presumption is that the temporary nature of the

[3] Indeed, it is ironic that the pension laws and regulations permit defined contribution plan participants to take the substantial longevity and investment market risks inherent in such plans and even expand them by providing many circumstances where those savings intended for retirement are available for other purposes (i.e., they are not fully locked in), yet those same laws and regulations do not permit participants to be exposed to the far smaller risks related to the wind-up of a defined benefit plan.

SOMEPP exemption from solvency funding is a *de facto* referral of the issue to OECP. MEBCO believes that OECP should strongly recommend that the SOMEPP exemption from solvency funding be made permanent. We also recommend that the SOMEPP definition be changed to incorporate all SMEPPs that permit benefit reductions, so there is no possibility of different treatment in Ontario compared to the Income Tax Act and Regulations.

Solvency requirements simply do not work for MEPPs that are funded through fixed negotiated contributions that are established for multi-year periods in collective agreements. The reasons include the following:

1. Solvency requirements are market-driven, requiring "market" valuations of assets and obligations. As markets are volatile, so solvency requirements are volatile. A world of fixed contributions simply cannot accommodate volatile pension costs.

2. Solvency requirements are based on maximum-cost utilization of subsidized early retirement. In practice, this almost never happens, so solvency requirements lead to holding assets for benefits that will never be paid. Ultimately, that excess money will not be needed, and so will become available for benefit improvements, but those improvements will go to a different generation from the one that contributed to cover the solvency requirements. In addition, of course, solvency funding means that excess assets will continue to be set aside for future generations, so the plan never "catches up" to where it can pay participants the benefits reasonably affordable from their contributions.

3. A MEPP's assets are always permanently committed to participant benefits – there are no surplus ownership issues, no contribution holidays, etc. That is, the total amount available in the extremely rare event of a MEPP wind-up will essentially be the same regardless of the benefit promise, and it will be distributed in its entirety to the participants. Therefore, at least in the aggregate, the lower benefit promise compelled by solvency requirements makes no change in the consequence of a plan termination. As a simple example, if a plan can afford a $700 pension on a going-concern basis and a $500 pension on a wind-up basis, solvency funding compels a $500 benefit both in the high-probability event (plan continuation) and in the low-probability event (wind-up). Without solvency funding, the benefit level is $700 in the high-probability event (plan continuation) and $500 in the low-probability event (wind-up). That is, holding down the pension for today's workers and retirees (to $500 in the example) does not help tomorrow's workers and retirees in the unlikely event of wind-up.[4]

In summary, solvency funding as applied to MEPPs punishes participants by providing inadequate pensions today without providing significant added protection to participants

[4] We recognize that there is a small impact, because more has been paid out in pensions so the assets are slightly less. This is unlikely to cause a meaningful difference on wind-up, and in any event what today's participants must give up is far more significant than any conceivable added value for future participants even if the highly unlikely event – MEPP wind-up – actually occurs.

in the event of a wind-up, and the chance of a wind-up is so low that it would make no sense to provide artificially low benefits today even if there were some added benefit on wind-up.

MEBCO fully supports the continued calculation, disclosure, and communication of the wind-up funded status to all plan participants and its implications in the unlikely event of a plan wind-up.

The recent modification to the funding regulations imposes more rapid funding of going concern unfunded liabilities on SOMEPPs than are applicable to SEPPs. As this serves to prevent MEPP participants from receiving benefits that can reasonably be provided, MEBCO believes these requirements are too restrictive and proposes that the going concern funding requirements for MEPPs be the same as are applicable to SEPPs.

In real life, most MEPPs were in reasonable shape even on a solvency basis prior to the 2001 – 2002 market declines and the continuing decline in interest rates. Thus, FSCO's attempted imposition of solvency funding requirements on MEPPs has led to converting the unlikely unfortunate event – benefit reductions on plan wind-up – into a certainty – benefit reductions today when a plan is in no danger of winding up. That outcome cannot possibly be good public pension policy.

Finally, we note that the United States has had special MEPP funding requirements for over thirty years and, unlike the requirements for SEPPs, there have never been any solvency-type funding requirements for MEPPs. As recently as 2006, new funding rules were enacted for both SEPPs and MEPPs, and this distinction was maintained. The collective judgment among regulators and MEPP Trustees and advisors is that the MEPP regime has been successful.

Grow-In Requirements

Ontario is unique in the Canadian MEPP environment in requiring certain participants who have not yet met the requirements for a subsidized early retirement pension to receive the subsidized benefits on plan wind-up. For a MEPP that only covers participants in Ontario, the fixed asset pool that is available in a wind-up gets allocated more heavily to younger, shorter service participants at the expense of retirees, survivors, and those who have met the requirements already[5] – an outcome of dubious value as a matter of public policy.

For a MEPP with participants in multiple provinces, FSCO's view is that grow-in requires a larger allocation of the fixed asset pool on wind-up to an Ontario member than will be allocated to an identically situated participant in another province. This leads to conflict (regulators and participants in other provinces object), litigation, use of plan assets for litigation rather than benefits, and delay in completing the wind-up.

[5] In general, FSCO requires assets to be allocated proportionately to each participant's wind-up liability in an actual wind-up. Grow-in increases the wind-up liability for those employees eligible for grow-in but not yet eligible for subsidized early retirement, while leaving the wind-up liability for everyone else unchanged. Consequently, the grow-in group receives more, while everyone else receives less.

MEBCO recommends that OECP support the elimination of mandatory inclusion of grow-in benefits on the wind-up of a MEPP except where assets remain after all other obligations have been met.

Adjustments to target benefits

All Canadian jurisdictions except Québec recognize that the fixed employer contribution obligation to a MEPP cannot be reconciled with an absolute ban on reductions to accrued benefits. Indeed, one of the requirements to be a SOMEPP is that the plan provisions permit benefit reductions. Thus, conceptually these plans have "target benefits" rather than true defined benefits. SOMEPPs are required to provide statements to all members and former members clearly advising them of the risks of benefit adjustments.

Québec has a different regime in this regard. Québec significantly limits negative adjustments to accrued benefits. Because it is not possible to both have fixed benefits and fixed contributions, Québec provides for employer "withdrawal liability" – employers who withdraw from a MEPP for any reason may, under certain circumstances, be required to make additional contributions beyond those that are provided in their collective agreements. This has had a chilling effect on the willingness of new employers to join MEPPs in Québec. Indeed, at least one national MEPP registered in Ontario has a specific provision prohibiting Québec employers from participating.

The Canadian pension system is a voluntary system, so employers will only contract to contribute to MEPPs if it is in their interest to do so. Limiting employer contributions to those that have been agreed to in collective bargaining is a critical advantage and recruiting tool for MEPPs. MEBCO strongly supports continuation of the present Ontario provisions that permit benefit adjustments where negotiated contributions set out in collective agreements turn out to be inadequate to support the target benefits.

Transfer values and other lump sum distributions

A MEPP that provides target benefits is, conceptually, a defined benefit (DB) plan that is intended to provide monthly payments for the lives of the participants after they retire. Philosophically, MEBCO is opposed to statutory requirements that allow DB pensions to be converted into defined contribution (DC) pensions or to be used for other purposes. Thus, we would like to see the mandatory requirements to pay transfer values repealed except with respect to small amounts. Realistically, we do not anticipate that such a repeal will happen with respect to terminating participants. We suggest, however, that it should be permissible for a plan to require survivors of deceased participants who are eligible for an immediate lifetime pension to take the pension and not have a lump sum cashout option. We also suggest that it should be permissible on plan wind-up to require non-retired participants who are eligible for an immediate lifetime pension to receive an annuity; currently they are required to be offered a lump sum instead.

The computation of lump sum payments is based on the full wind-up liability for the participant as of the measurement date. Subject to certain limits, 100% of the commuted value is paid even if the plan is not fully funded on a wind-up basis. This is logical for a

plan that is subject to additional contributions designed to fund the plan fully on a wind-up basis in a short time period because, at least in theory, the participant taking the transfer value is treated similarly to the participants who elect to leave "their money" in the plan for a deferred annuity and the continuing active employees who have no lump sum option. In the absence of solvency funding, however, there is no attempt to fully fund a MEPP on a wind-up basis. In that case, the withdrawing employee electing a transfer value receives preferred treatment – 100% of the commuted value when the expectation is that in an actual wind-up the remaining participants will receive less than 100 cents on the dollar. MEBCO therefore recommends that any lump sums or other transfers (e.g., annuity purchases) be paid based on the wind-up funding level of the most recently filed actuarial report (but not in excess of 100%), with no subsequent payment of the withheld amount. In addition to the equity argument, that will also encourage the socially desirable outcome – taking a deferred annuity.

Finally, some years ago the Government enacted legislation permitting plan participants with a shortened life expectancy to withdraw the value of their pension from any plan. The language was poorly crafted, so that it does not restrict this right with respect to a DB plan participant who has already retired. Thus, an 80-year-old pensioner who is near death can theoretically request the value of his or her pension. That is actuarially unacceptable, because the computation of the funding requirements and determination of benefit levels assumed a mortality decrement that would terminate payments at each age after retirement, and the withdrawal of the value of the pension just prior to death effectively overrides this basic element of the determination. The Canadian Institute of Actuaries provided a "fix" for this problem by prescribing that the value of the pension in this case be determined assuming that the retiree has only four months left to live. It would be preferable to correct the drafting error by eliminating the cash-out right for DB plan retirees altogether.

Suspension of benefits

Fundamentally, a pension represents the deferral of a portion of a worker's earnings to provide financial support after leaving the work force. In the DB environment, it is a collective deferral, and any individual may receive more or less than the value of his or her own deferral. In most of Canada, if a retiree returns to work within the coverage of the plan, the plan may choose to suspend pension payments or, alternatively, it may choose to provide no new accruals during the reemployment period. In Québec, the election is made by the participant rather than by the plan. In the absence of a meaningful suspension rule, there are undesirable consequences, both economic and social. First, plan assets get used for other purposes than retirement, leaving less (in the case of a MEPP with fixed contributions) available for the plan's primary purpose. Second, it encourages employees to change employers, because a salary plus a pension is obviously more valuable than either one alone. Third, it forces employers to subsidize their competitors, who can pay lower wages if they can recruit skilled workers who will be collecting a pension as a supplemental income source. Fourth, it potentially turns the plan into an unemployment benefits (SUB) plan – the participant collects a pension when he or she is not working and a paycheque when there is work available. Under the

Québec model, there is a strong incentive to retire at the earliest possible date, start receiving a pension, return shortly thereafter to the same employer in the same position, and elect the option of no new accruals in lieu of suspension. This is particularly onerous if it involves a MEPP with a service cap, because the loss of future accruals may be meaningless.

MEBCO supports giving the trustees of MEPPs the broadest reasonable authority to suspend pensions. The American pension laws permit MEPPs to suspend benefits for employment "in the same industry, in the same geographic area covered by the plan, as when such benefits commenced." We propose that Ontario adopt that model.

Obligations with respect to a change of bargaining representative

Ontario's labour laws allow employees, under certain circumstances, to change their collective bargaining representative. Most MEPPs involve only a single union; a few involve several. In many cases, a change in bargaining representative carries with it a change from one MEPP to another. Ontario's pension laws allow the new union to compel a transfer of the accrued benefits and related assets from the prior union's MEPP to its own.

MEBCO understands that it is appropriate to let workers change who they wish to have represent them and to discourage unions from using their MEPPs as an obstacle to such changes. Nonetheless, such a forced transfer is typically not actuarially neutral for the former union's plan, and the only thing that the transfer accomplishes that could not be dealt with absent a transfer is that the participant receives one monthly cheque rather than two at retirement. In at least one case, the arguments with respect to the transfer obligations have been going on for years and are currently before the Financial Services Tribunal.

We recommend that the current requirement be deleted and that any transfer be optional and only with the mutual consent of the trustees of the plans, subject to the approval of the Superintendent. Further, we recommend that, in the absence of a transfer, the former union's plan be permitted to delay payment of the pensions or transfer values of affected members until they are eligible for payment from the new union's plan.

Qualification of audited financial statements with respect to employer contributions

The Superintendent's position is that each MEPP must annually file audited financial statements where the auditor gives a "clean" or "unqualified" opinion on those statements. For many MEPPs, particularly in the construction and entertainment industries, this is simply not possible with respect to employer contributions. These plans have large numbers of employers, many often work in the jurisdiction of the plan sporadically or only for a single project, many have the contributions paid from a central location for all work in Canada, some create separate companies for each job, and in some cases the individual employers are small and the cost of auditing their records would be excessive compared to any possible computational errors. MEBCO accepts that the Superintendent cannot simply agree to accept as accurate one of the critical

elements of the financial statement, the employer contributions, with no confirmation. Therefore, we propose that the auditor be permitted to opine on the adequacy of a MEPPs process for insuring collection of obligated contributions without requiring that the auditor opine on the accuracy of the reported contributions themselves.

PBGF coverage

Given the rarity of MEPP plan wind-ups and the technical complexity of designing an appropriate MEPP guarantee program, MEBCO is opposed to PBGF-type coverage for MEPPs.

Multi-jurisdictional plans

Some MEPPs are regional or national in their coverage. As with all multi-jurisdictional plans in Canada, the variances from province to province and regulator to regulator increase the cost and complexity of plan administration and interfere with the desired business objective of treating identically situated workers identically. For MEPPs covering workers in Ontario, the main difficulties occur because of the substantial differences between Ontario and Québec. These reflect substantial differences in the pension laws themselves, compounded by the size of the work forces in the two provinces and the mobility of labour across the provincial border. As a worst-case, real life example, if a plan covering participants in both provinces needs to reduce accrued benefits, Québec's view is that the entire reduction must be applied to the Ontario members, because Québec's pension laws forbid reductions in accrued benefits.

It is likely that all plan sponsors of multi-jurisdictional plans nationwide as well as most advisors would be supportive of a single national regulatory regime. That is beyond the OECP's power or mandate, but MEBCO recommends that an attempt be made to conform the rules in Ontario and Québec. That would eliminate most of the problems and serve as a model for the rest of Canada.

Feasability of MEPPs for small employers' non-bargaining employees

When MEBCO met with representatives of OECP, we were asked for our view of the feasability of MEPPs for small employers' non-bargaining employees. This issue is not within our mandate, but we do have a few comments.

- The principal advantages we perceive with respect to such programs relate to potentially significantly lower plan operation costs (administrative and investment) and increased availability of investment options and expertise.

- There are limits to the increased administrative efficiency because, absent the compulsion of collective bargaining, pooling of actuarial experience is impractical – the cost will vary substantially from employer to employer, so it is likely that asset, actuarial liability, benefit level, employer contribution, and accounting compliance will need to be done on an employer-by-employer basis. It would be better to

encourage financial institutions to create model small employer plans where there are simply a few blanks to fill in to create a SEPP with low expenses.

- Unless such a plan was hugely successful, plan assets would likely be invested in pooled funds that are already available to smaller plans. Thus, it is not clear that the investment performance would be enhanced significantly.

- The major impediments to the growth and creation of defined benefit pension plans, in our opinion, are solvency funding and settlement accounting. The high business failure rate for small employers (the potential participants in a pooled arrangement) and unwillingness of employers to be insurers with respect to business failure of their competitors makes it unlikely that solvency funding could be eliminated for such plans. Changes in the accounting rules are beyond OECP's mandate and are becoming more onerous and volatile, not less so.

We understand why the concept is attractive and are pleased that OECP recognizes the success of the MEPP model and wishes to extend it. We are doubtful, however, that it will be successful absent collective bargaining.

Regulatory and legislative mandate

As previously noted, the Canadian pension system is a voluntary system. The tools are available to provide complete benefit security – group immediate and deferred annuities. History has made it clear that these mechanisms potentially impede the willingness of employers to opt to provide defined benefit pensions and the willingness of employees to defer compensation in order to participate in such plans.[6] At the other extreme, plan participants in unfunded or poorly funded plans have been financially devastated when funding has been grossly inadequate and the sponsoring employer has become insolvent (or, in the case of one or two MEPPs, the industry has moved production out of Canada). Clearly, the challenge for the government is to find a fair balance so that employers and employees both see the creation and maintenance of defined benefit pension plans as being in their interest.

In Ontario, the regulator, FSCO, has interpreted its mandate primarily as one of providing a high level of benefit security with respect to accrued pension "promises," even if that inhibits the creation, maintenance, and growth of such promises. We strongly encourage OECP to support a change of direction in Ontario's pension laws, regulations, and regulator focus towards a better balance of "risk and reward." The current emphasis on minimizing risk with respect to accrued benefits is also minimizing the rewards that come with a healthy, thriving defined benefit pension system – adequate retirement income, capital formation, and employee ownership of Canada's enterprises. Canada's prized "three-legged-stool" of retirement income (government programs, employer-sponsored

[6] In the early days of funded pension plans, benefits were often fully funded as they accrued by the purchase of deferred annuities. Benefits were fully secure, usually inadequate, extremely expensive, and the plan designs fit the insurance policies, not the needs of employers and employees. The growth of pension plans accelerated dramatically when this method of funding was abandoned.

programs, and private savings/home equity) has brought the country economic success and less poverty among the elderly than among workers. That is a remarkable achievement. MEPPs play an important role with respect to the second leg. Public policy must encourage the continuation of this model, not inhibit it.

Conclusion

MEBCO is pleased that OECP is taking a holistic view of the pension laws and regulations, particularly as they have developed to a significant degree by scratching specific itches without adequate or accurate anticipation of the unintended consequences. We look forward to actively participating in this process, and are available to assist in your understanding and addressing the special issues related to one of the most successful parts of the pension system, multi-employer negotiated contribution defined (target) benefit pension plans. Further, recent experience suggests that proper legislative and regulatory drafting requires the active participation of those actively involved in MEPPs, and MEBCO would be pleased to provide such assistance.

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