2017

Brief to the Nova Scotia Government

IN RESPONSE TO THE PROVINCE'S PENSION FUNDING FRAMEWORK REVIEW

ON BEHALF OF MEMBERS OF THE CANADIAN COALITION FOR RETIREMENT SECURITY

Executive Summary

The Canadian Coalition for Retirement Security (CCRS) is pleased to provide these comments on behalf of 10 of our coalition partners (see Appendix 1) in response to the government of Nova Scotia's consultation paper entitled "Pension Funding Framework Review and other issues affecting pension plans". The CCRS is a coalition of organizations with a common interest in promoting the retirement security of their members.

In undertaking its review of the province's regime for pensions, the government must ensure that its conclusions respect two fundamental principles:

1) Pension Promises must be Honoured

   This means that existing pension promises, such as earned defined benefit (DB) pensions that have already been earned, must be respected. Employees have provided their services in exchange for various benefits, including wages paid via regular paycheques and deferred wages that will be paid after retirement. Those deferred wages are an explicit component of the employment contract. Unilateral changes to the benefits that employees have accrued under those employment contracts must not be considered, any more than one could consider changing the wages that were paid in past years.

2) All Stakeholders must have a Voice

   One of the key challenges in the consideration of target benefit pension plans (TBPs) is ensuring that all stakeholders – active employees, individuals with deferred pensions, retirees and their survivors – have a voice in the governance of the plan. Trade unions provide effective representation for their active members, but cannot represent the interests of non-members such as retirees (i.e., existing pensioners). The problem of establishing an effective voice for pensioners who could be subject to a TBP is a challenge – regardless of whether the workplace is unionized – a challenge that could be fatal to the establishment of such plans.

In this submission, the CCRS limits its comments to the three discussion questions in Part 2 of the Consultation Paper related to the establishment of TBPs:

> 8. Should Nova Scotia proceed with developing a regulatory framework for target benefit pension plans?
>
> 9. Should target benefit pension plans be restricted to unionized environments?
>
> 10. Should defined benefit plans be permitted to convert to target benefit plans, including benefits earned in the past?

The CCRS recommends that the government of Nova Scotia develop a legislative framework that would permit the introduction of TBPs as new plans (where no plan exists in a workplace) or on a forward-looking basis (where a workplace has an existing pension plan). To the extent that the existence of such a framework could encourage employers to offer a TBP where no pension plan is currently offered, or to replace a defined contribution plan with a TBP, the retirement security of some Nova Scotians could be enhanced. However, care must be taken to ensure that such a framework does not merely encourage employers to replace existing DB plans with TBPs, to the detriment of the retirement security of their employees.

In consideration of the principle that *Pension Promises must be Honoured*, the enabling legislation should not permit the accrued benefits from an existing DB plan to be unilaterally converted to a TBP. Further, although the notion of permitting such conversions subject to the informed consent of affected individuals may have some appeal, in practice, it will be difficult to design and implement a process that achieves informed consent. The CCRS therefore recommends that the government instead opt to protect the retirement security of Nova Scotians with DB pension plans by not allowing the conversion of such plans to a TBP under any circumstances.

Finally, the CCRS sees no need to restrict the offering of TBPs to unionized environments. Although the presence of a union solves the need for representation of current employees in the initial creation and the ongoing governance of a TBP, it does not address the need to provide a voice for existing retirees and pensioners in those processes. That greater challenge of ensuring a voice for existing retirees and pensioners will remain, regardless of whether the workplace is unionized.

Introduction

In September 2017, the government of Nova Scotia released a consultation paper entitled "Pension Funding Framework Review and other issues affecting pension plans". The consultation paper invites comments from interested parties on various issues related to the regulatory framework for pension plans in Nova Scotia.

The Canadian Coalition for Retirement Security (CCRS) is a 21-member collaborative organization[1] which represents more than five million working and retired Canadians who believe in retirement security. The CCRS is focused on ensuring that any proposed implementation of target benefit pension plans (TBPs) does not negatively impact the earned retirement security of Canadians, in general, and of its members, in particular.

Accordingly, in this submission, the CCRS provides its comments on the three discussion questions regarding TBPs, as posed in Part 2 of the consultation paper:

> 8. Should Nova Scotia proceed with developing a regulatory framework for target benefit pension plans?
>
> 9. Should target benefit pension plans be restricted to unionized environments?
>
> 10. Should defined benefit plans be permitted to convert to target benefit plans, including benefits earned in the past?

In the following, the CCRS will first identify the guiding principles which should direct the government of Nova Scotia's deliberations in this consultation process, following which it will address each of the above discussion questions, in turn.

Guiding Principles

The overarching principle that should guide the government in its deliberations on pension reform is that existing pension promises must be honoured. No measures should be taken that would allow employers to retroactively change the labour bargain into which they have explicitly or implicitly entered with their employees[2]. In short,

Pension Promises must be Honoured

In workplaces without any form of retirement savings plan, measures to encourage employers to establish such a plan would be a positive development and would contribute to employees' retirement security. There are no existing pension promises; accordingly, any new pension

[1] The member organizations of the CCRS are listed in Appendix 1

[2] Throughout, references to "employees" generally refer to current employees, pensioners or their survivors, and individuals with deferred pensions.

promises, including those under a TBP should the government enable legislation providing a legal framework for such plans, would fill that void.

In a workplace that offers defined contribution (DC) pension plans or Registered Retirement Savings Plans (RRSPs), no commitment to the level of benefits has been made. The contributions have been defined up front and it is understood that the retirement benefits paid out will be commensurate with the ultimate value of the plan. In this case, employees may find that a TBP would be preferable, or they may decide otherwise. The salient point is that conversion of a DC plan or RRSP into a TBP would not break pension promises that have already been made.

However, pension promises have already been made where Defined Benefit (DB) pensions are in place: employees have offered their services in exchange for various benefits, including wages paid via regular paycheques and deferred wages that will be paid after retirement. Those deferred wages (i.e., the DB pension) are clearly defined, typically based on factors such as length of employment and wages, and are an explicit component of the employment contract. Unilateral changes to the benefits that employees have accrued under those employment contracts must not be considered, any more than one could consider changing the wages that were paid in past years.

In theory, it could be acceptable to change an individual's accrued defined benefits with his or her informed consent but, as discussed further in this submission, there are significant concerns that make such an approach challenging to implement, in practice.

A further guiding principle in the context of TBPs is that

All Stakeholders must have a Voice

One of the complexities of TBPs is the potential for inter-generational conflict, or conflict between the desires of current and former (retired) employees, particularly in situations where a TBP experiences a funding shortfall. It is critical that all stakeholder groups be part of the negotiations necessary to establish a TBP in the first place, and play a role in the governance and administration of a plan. That is easy for employers and for employees in a unionized environment, but ensuring the presence of representative voices for non-unionized employees and for retirees is a challenge.

Discussion Question 8

Should Nova Scotia proceed with developing a regulatory framework for target benefit pension plans?

TBPs, also known as “shared risk plans”, shift the risk in pension plans from employers and plan sponsors to employees and retirees. Funding requirements are generally weaker than those applicable to DB plans and, in tough times, TBP benefits can be reduced, providing less retirement security for their members. TBPs are a new element in the Canadian pension landscape, with some provinces implementing them in different ways, and have emerged in part because of pressures on DB plans.

Before considering a new pension framework, recognition and understanding of the ongoing importance, relevance and health of DB pension plans is essential.

Well-managed, disciplined DB pension plans are proven to make retirement secure. As reported by OMERS, a Boston Consulting Group (BCG) 2013 study[3] suggests that large DB plans provide Canadians with one of the strongest retirement income systems in the world and contribute significantly to national prosperity. In another study, OMERS reports that BCG found that benefits paid out to DB plan members cycle back into the Canadian economy in the form of consumer spending and taxes, generating business growth and employment[4]. Retirees with DB plans are also less likely to rely on government assistance[5]; and solid retirement income security brings better health status and outcomes, which reduce demands on the health care system.

DB plans are the most effective means of generating retirement security, but unfortunately, DB pension coverage has been declining[6]. In the private sector, there has been a significant drop in the proportion of employees with defined benefit pension coverage, from 87% in 1993 to 37% in 2011 (Aon-Hewitt, 2015). There has been a significant shift to DC plans, and many employers have eliminated their pension plan altogether.

For some plan sponsors, this trend has emerged because of pressures on pension plan funding since the market recession of 2008. In the nearly ten years since that occurred, though, DB plans are performing better on the short term and improving their long-term outlook. Aon Hewitt found that as of January 1, 2017, median DB plan solvency was up to 94.9%, from 86.1% on January 1, 2016, while fully funded status increased from 10.7% of plans to 35.2% during the same period[7]. Similarly, OSFI reports that, for federally-regulated plans, as of 31 December 2016, the

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[3] http://www.omers.com/pension/employers_news_article.aspx?newsid=6556: **“Canada's top Ten Pension Funds Help Drive National Prosperity, Landmark Study Finds”, June 6, 2013**

[4] http://www.omers.com/pension/employers_news_article.aspx?newsid=6556: **“Canada's top Ten Pension Funds Help Drive National Prosperity, Landmark Study Finds”, June 6, 2013**

[5] http://www.omers.com/pension/employers_news_article.aspx?newsid=6746: **“New analysis confirms that defined benefit pensions provide significant benefits to Canadian economy”, October 22, 2013**

[6] Statistics Canada, Pensions: The ups and downs of pension coverage in Canada, 2017

[7] Aon Hewitt, 2017

weighted average solvency ratio was 97%, with 20% of plans being fully funded.[8] Both figures reflect substantial improvements over the levels reported in 2011 and 2012. For plans regulated by Nova Scotia, more than sixty percent of pension plan members are in plans that are fully funded, and three-quarters of plan members are in plans that are 80 percent solvent or better[9]. And again, in Nova Scotia, the province recently permitted an extension to solvency funding from the standard five years to 15: funding levels are sound, and this measure will enable some plans to continue to improve and ease immediate pressures on them. Clearly, these findings signal a shift back from the edge for DB pensions, brought on in part by the economy and post-2008 financial woes.

That said, the government needs to remain vigilant with respect to the underperforming DB pension plans, as it is those plans that are most at risk of defaulting on their pension promises. This is particularly important, given that Canada's present bankruptcy and insolvency laws fail to preserve the pension promise when firms enter bankruptcy or insolvency protection with an underfunded pension plan.

Some organizations have leaned heavily on the refrain that DB pensions are "unsustainable" and that lawmakers must enable TBPs that allow retroactive conversion of accrued DB pensions. As the statistics cited above demonstrate, DB plans are generally quite healthy – a vast improvement from even five years ago when the value of plan assets was reduced after the 2008 market correction while plan liabilities increased because of lower interest rates. In the current environment, there simply is no reason to jettison the DB pensions promised to hard-working Nova Scotians.

The CCRS believes that TBPs could provide an option for making retirement secure and dignified for some Nova Scotians – if TBPs are done fairly and in the right way as new plans or on a go-forward basis only. TBPs could enable plan members to benefit from risk and longevity pooling, and may provide a core or defined lifetime pension benefit, something not offered by DC plans. TBPs may also be a step above voluntary products such as RRSPs and DC plans, which are currently the only alternatives to DB plans.

However, the government should be under no illusions: for the most part, calls to enable TBPs are not to create new pension plans where none currently exist. The goal is to enable TBPs and allow employers to shrug off their DB pension promises. TBPs should not be enabled at the expense of good DB pensions. As noted in *Guiding Principles* above, DB pensions are deferred compensation. Pension promises must be honoured: employers should not be allowed to renege on defined benefits after they have been earned.

In summary, the CCRS recommends that:

[8] OSFI, InfoPensions, Issue 17, May 2017

[9] Report of the Superintendent of Pensions on the Administration of the Pension Benefits Act for the Year Ending March 31, 2016

The government should establish a legislative framework for target benefit plans as new plans or on a forward-looking basis in workplaces with existing plans. Target benefit plans must not be enabled at the expense of earned defined benefit pensions.

Discussion Question 9

Should target benefit pension plans be restricted to unionized environments?

In considering whether to implement TBPs only in unionized work environments, Nova Scotia must consider representation principles and the treatment of accrued DB pensions under the TBP framework.

Unions can negotiate pension arrangements on behalf of active employees. Broadly speaking, union membership is mandatory and union members typically provide input to their union on key bargaining issues. The democratic structure of unions means that constituent members are involved in positions and decisions taken by the union. In unionized workplaces, TBP members have a voice in the plan's governance, consistent with the guiding principle noted above.

However, if the conversion of earned DB pensions to a TBP is permitted in a unionized environment, accrued DB pension benefits can become part of bargaining and punitive tactics such as lock-outs could be used to force pension concessions from employee groups. Ugly intergenerational conflicts could arise inside workplaces, as the priorities of employees near retirement and those further from retirement may be inimical. Moreover, if plan conversions are permitted, the financial security of current retirees could be bargained away without their being at the bargaining table, as unions speak for their active members but do not represent retirees. Unions must not be placed in a position where they can be forced to cede their members' earned pensions through collective bargaining nor should they be allowed to bargain away the earned pensions of individuals who are no longer union members.

Assuring representation for retirees – current and future – is challenging in both unionized and non-unionized environments.

Non-union workplaces do not have the structure and advantages in collective bargaining that are possible thanks to unions. Neither employees nor retirees are formally represented in negotiating. Although a formal entity to represent employees' interests in a TBP context could be created in non-unionized environments, retiree representation (current and future) would remain an issue.

Retiree representation in the establishment and governance of a TBP is critical, to respect the principle that *All Stakeholders must have a Voice*. This is particularly important if the TBP framework permits the conversion of accrued DB pensions – a situation that the CCRS does not support, as discussed in response to Discussion Question 10, below. If the TBP framework permits conversion of DB plans to TBPs, existing retirees are at risk of having the basis for their pensions changed – and they must be party to any negotiations. Even if the TBP framework allows for TBPs on a going-forward basis only, a role in plan governance must be reserved for future retirees, to protect their interests in the event of plan funding shortfalls.

In short, union presence in the workplace only partially solves representational requirements. If pensioner representation in establishing and governing a TBP can be solved, there is little reason to limit TBPs to unionized environments.

Given that the challenge of ensuring an adequate voice for retirees and pensioners in the establishment and ongoing governance of a TBP exists in both unionized and non-unionized scenarios, the CCRS concludes that:

Target Benefit Plans need not be restricted to unionized environments, provided that all stakeholders – including retirees – have a voice.

Discussion Question 10

Should defined benefit plans be permitted to convert to target benefit plans, including benefits earned in the past?

As noted above, the overarching principle that should guide the government in its deliberations in this consultation process, is that *Pension Promises must be Honoured*.

A TBP, by definition, is incapable of achieving the existing pension promises associated with DB plans. The DB plan's promise is that a specific amount will be paid throughout an individual's retirement years. In return, the employee will have already provided the service necessary to earn that benefit. In the specific case of retirees, their work life has been lived, and their accrued benefit corresponds to their entire service with that employer. In the case of active employees, at any given time they may have made contributions to their DB pension plan and will have earned some pension benefits in respect of their service.

By contrast, a TBP contemplates that the benefits that a pensioner will receive can be reduced. For retirees receiving a DB pension, conversion to a TBP puts their pension payments at greater risk: if the plan performs poorly, then one of the measures permitted would be for employers to reduce the pension payments. For active employees who have accrued DB benefits, a conversion to a TBP would mean that their pensions would also be affected negatively under the same circumstances.

Thus, permitting the unilateral conversion of accrued DB pensions to TBPs would violate the guiding principle that *Pension Promises must be Honoured.* For this reason, the CCRS has recommended in its response to Discussion Question 8, above, that TBPs should only be allowed as new plans or on a go-forward basis for workplaces with an existing plan. In other words, the conversion of earned DB benefits to TBPs should not be allowed.

It is instructive to note that, for the most part, Canadian pension standards legislation protects accrued defined benefit pensions. In Saskatchewan, Nova Scotia, British Columbia and Alberta, legislation enabling TBPs has not permitted the conversion of a DB plan to a TBP on a retroactive basis. New Brunswick is the only province in which legislation allows this type of conversion (albeit currently subject to legal challenges by that province's retirees and labour organizations).

In the federal context, the Liberal government introduced Bill C-27 (*House Government Bill C-27, An Act to amend the Pension Benefits Standards Act, 1985*) in October 2016. That legislation, which remains at first reading as of this writing, would allow accrued DB pensions to be converted into TBPs only with individual, informed consent. Plan members and retirees who do not consent would maintain their accrued pensions, pursuant to their current plan.

In the following subsection, the CCRS describes its concerns with a "conversion with consent" model.

Conversion of accrued pension benefits, with consent

In theory, it would be acceptable to enable individuals with accrued DB pensions to consent to convert to a TBP. It will generally not be in their best interests, but individual DB plan members may view things differently. For example, some members of a DB plan could be attracted by the opportunity under a TBP to benefit from any plan surplus. In any event, a conversion of accrued DB pensions would amount to a retroactive change to the individual's employment contract; one could reasonably argue that, as a party to that contract, the individual should be free to consent to such a change.

However, the CCRS believes that the practical difficulties with a conversion-with-consent model should dissuade the government from pursuing such a scheme.

The challenges with consent in a unionized environment are discussed in response to question 9, above. To reiterate, a model which enables a union to provide consent for plan conversion on behalf of its members will put accrued DB pensions on the bargaining table. Employers would then have the normal collective bargaining tools, such as lock-outs, available to them to "encourage" union agreement with a conversion proposal. This situation simply must not be permitted: *Pension Promises must be Honoured.*

Moreover, in a unionized workplace, unions can speak for the members they represent; they do not and cannot represent retirees. With such a consent model, retirees could be vulnerable to having their earned pensions bargained away – without their input – if employers and unions are negotiating the pension outcome. Such an approach would fail the key principle that *All Stakeholders must have a Voice*.

On paper, the federal Bill C-27 provides a possible model for consent for non-unionized employees and for retirees: conversion of accrued DB pensions to a TBP would only be permitted with informed, individual consent, and provisions would be established to ensure that full and appropriate information is provided to enable an informed decision. In the federal model, a positive form of consent is required: i.e., the individual must positively indicate his or her consent with the conversion proposal. Negative option models, which have been banned for such routine transactions as cable television or magazine subscriptions, are clearly inappropriate for choices affecting one's retirement income, which for many people is the single biggest financial asset they have.

The federal model appropriately requires individual consent to any proposed pension conversion, as the DB pension promise is contracted on an individual basis. The individual plan member is told what his or her pension will be. The pension promise pertaining to one plan member is not contingent on the pension promise pertaining to other plan members. Individuals expect that his or her pension promise will be honoured, independent of the choices made by others.

The intent of the consent provision in Bill C-27 is honourable, yet the CCRS is concerned that, in practice, the requirement for obtaining "informed" consent will be challenging to ensure.

First, the conversion-with-consent approach would require the provision of accurate and complete information in an unbiased manner, free from any kind of coercion, in a form and language that the individual can understand. Experience from New Brunswick, which introduced shared-risk plans (i.e., TBPs) in 2013, demonstrates the difficulty of communicating clearly and simply about the exceptionally complex TBPs without misleading plan members. In this respect, we note the concerns that have been raised about the information provided by the government of New Brunswick to encourage support for the legislation that introduced TBPs[10]. If that could happen in the context of "selling" legislation, it could certainly happen in communications from an employer to "sell" the conversion of a pension plan.

A pension framework that permits the conversion of accrued DB pension plans to TBPs will make the pursuit of such conversions irresistible to employers with DB plans, whether in the public or the private sector: employers would be able to simply walk away from pension promises they have already made to employees and retirees. Such incentives would place a tremendous onus on government regulators to ensure that accurate, complete and unbiased information is communicated to those with accrued DB pension benefits to request their consent to convert. That is a tall challenge, given the uncertainties and complexities of a TBP model.

As a result, the CCRS believes that a conversion-with-consent model will be unable to meet the challenge of ensuring that individuals are provided with complete knowledge of the relevant facts, including the risks involved and possible alternatives, before providing consent. There would have to be opportunities to ask questions and clarify all doubts. In consideration of the complexities of pension issues, these safeguards will be difficult to satisfy in practice.

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[10] See, for instance, http://business.financialpost.com/news/fp-street/seeking-full-disclosure-on-new-brunswicks-shared-risk-pension-model

Secondly, a requirement to obtain the informed consent of individuals to a conversion of their DB pensions implies a duty to ensure that vulnerable individuals are respected and protected as part of the consent process. The government should play a proactive role in protecting those individuals who for either or both of the following reasons, may not be able to provide truly informed consent.

The first reason that an individual's consent may not be "informed" is financial literacy. A DB pension plan can provide a critical part of post-retirement income for many Nova Scotians, yet many may not fully appreciate the negative implications of a conversion of their pension to a TBP, perhaps opting to simply trust the employer with whom they spent their career and the government that is responsible for providing a sound legislative and regulatory framework to protect their interests. With the primary effect of such a conversion being a shift of pension risk from the employer to the individual, and with pensioners generally understood to be risk-averse, it is indeed difficult to foresee a scenario where an individual who is truly informed and who properly understands the information would agree with such a conversion. Moreover, many retirees are on limited, fixed incomes, without the resources to obtain the independent financial advice that could contribute to alleviating this concern.

The second concern in considering whether pensioners should be put in a position wherein they could mistakenly agree to changes in their pension, one must consider the realities of that demographic group. Most retirees are likely to be senior citizens, which in turn is likely to include vulnerable individuals – whether the retirees themselves or their survivors. Being senior citizens, these individuals are unlikely to be able to return to the workforce to make up for any pension losses that could result from a TBP. In addition, one must question whether some individuals within this group can provide informed consent: obviously, in situations where an individual has been found not capable of making financial decisions, others can do that on his or her behalf, subject to a power of attorney mechanism. Yet the government should be concerned about protecting those individuals who may suffer mild cognitive impairment – the risk of which increases with age – which should cast doubt as to their ability to truly provide informed consent to changes to something as complex and important as their pensions.

Thus, while a conversion-with-consent model has a degree of appeal from a theoretical perspective, the CCRS believes that it is unlikely that truly informed consent is achievable, and equally unlikely that all plan members who will be asked to surrender their DB pension will understand exactly what they are being asked to consent to. Given that employers who are proposing a conversion will have a vested interest in achieving that specific outcome, the CCRS sees a significant risk of the exploitation of vulnerable individuals. The government must play a role in protecting these individuals.

For these reasons, the CCRS recommends that the government conclude that

There should be no conversion of accrued DB pension benefits, even with consent.

Summary

The government should be guided in its deliberations on potential changes to its pension legislation by two fundamental principles:

Pension Promises must be Honoured
and
All Stakeholders must have a Voice

TBPs introduced as new plans or on a go-forward basis only for existing plans could provide an option for making retirement secure and dignified for some Nova Scotians. However, it appears that much of the appeal of TBPs stems from the misguided belief that it would be appropriate to convert accrued DB pensions to TBPs. CCRS urges the government to resist calls to allow such conversions, even conditional on obtaining informed, individual consent. Decisions about pensions are too important, yet so complex to expect that truly informed consent can be provided in many cases. Instead, the government should act to protect the income security of retirees – many of whom are vulnerable seniors - by rejecting the notion of allowing the conversion of accrued DB benefits to a TBP.

The CCRS sees no benefit in restricting the offering of TBPs to unionized environments, provided the above conditions are met and that *All Stakeholders have a Voice*. Although the presence of a union solves the need for representation of current employees in the initial creation and the ongoing governance of a TBP, it does not address the need to provide a voice for existing retirees and pensioners in those processes. Moreover, should the government permit the conversion of accrued DB pension benefits to a TBP, a union could find itself in the untenable position of being pressed to bargain away the earned DB pensions of its members and former members, contrary to the principle that *Pension Promises must be Honoured*.

We applaud efforts by the Nova Scotia government to consult with organizations and individuals on this important issue, and we were particularly pleased with discussion questions focused on how target benefit plans should be implemented and the approach to accrued defined benefits. This nuanced conversation is very important.

With ongoing meaningful dialogue involving employees and retirees, non-profit organizations, labour organizations, businesses, and others, Nova Scotia will find the best solutions to protect and improve pension coverage and retirement security for generations to come.

Appendix 1
Member Organizations of the Coalition endorsing this submission

Aboriginal Veterans Autochtones

Bell Pensioners' Group

Canadian Association of Retired Teachers

Canadian Merchant Service Guild

Canadian Naval Air Group

Canadian Peacekeeping Veterans Association

CBC Pensioners National Association

National Association of Federal Retirees

Newfoundland Coalition of Pensioners, Retirees and Seniors Organizations

The Professional Institute of the Public Service of Canada