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ARTICLES OF INTEREST

A Proposal to Protect Pensioners of Insolvent Companies

By Michael Powell, President, *Canadian Federation of Pensioners*

The COVID-19 pandemic is exacerbating the vulnerability of Canadian defined benefit pensioners and there will be significant business insolvencies and pension failures to come. As businesses struggle to remain solvent, it is likely that more pension plans will have greater unfunded liabilities than in the past. This means that thousands of pensioners may experience a dramatic cut in their pension income in the event of insolvency.

The majority of future distressed pensions will almost certainly have greater unfunded liabilities than in the past. With Quebec, Ontario and BC permanently reducing/eliminating solvency requirements and the federal government temporarily reducing/eliminating solvency payments, well over 90% of private defined benefit pensions are now regulated in regimes that have abandoned 100% solvency targets.

Typically, companies become insolvent at low points in the business cycle, the same point in the cycle when pension solvency funding tends to be low. The current process is to annuitize the pension as quickly as possible. Annuitizing the pension at a low solvency level crystallizes the loss, leaving pensioners facing a shortfall for the rest of their lives. To exacerbate the problem, setting up annuities drains funds from the pension plan. Should the company fail in a generally poor economy it is likely there are other companies failing at the same time creating competition for annuities driving the costs of the annuities up, reducing pension funds available to pensioners even further.

We believe there should be three key tenets:

1. Pensions are deferred wages. They are earned while working, payable after retirement.
2. Pensioners deserve the pension their former employer committed to.
3. Governments have undermined pension security by granting themselves total control over pensions and passing legislation detrimental to the financial security of pensioners. They need to accept responsibility for solving the problem.

For over a decade, we have proposed innovative solutions to governments and the media to address this problem in whole or at least in part.

These include:

- Creating a national pension insurance program that insures 100% of the pension liability and is fully funded by the plan sponsors.
- Amending insolvency legislation to extend super priority to the unfunded pension liability.
- As a short-term measure, introducing a refundable tax credit equal to the amount of pension loss an individual incurs when a pension fails.
- Establishing a commission with the explicit goal of determining the best way to ensure pensioners receive 100% of the pension they paid into and to which their employers committed.

While none of these solutions are perfect, and present jurisdictional challenges and potential stakeholder resistance, CFP and our partners believe they offer credible opportunities to fully protect pensions. Ultimately, we are solution agnostic -- our only objective is to ensure pensioners receive 100% of their pension.

The COVID-19 pandemic has also compelled us to think more broadly about tools for protecting defined benefit pensioners. Working with other pension sector stakeholders, we have developed another potential solution: a distressed pension facility.

A Solution for Distressed Pensions

This new solution is to establish a distressed pension facility that allows pensions of insolvent companies to carry on as active plans.

Insolvency legislation would be changed to trigger the transfer of the pension plan on filing if the plan is underfunded on a solvency basis. If, on filing of insolvency, the plan is funded to a level that would provide plan members annuities equal to 100% (or more) of their pensions, the pension would be wound up and annuitized. Plan members would be given the option of commuted value or annuity at the funding level at insolvency filing, essentially receiving their share of the plan assets.

This would create a new form of pension plan and patterned after multi-employer plans. Plans from multiple insolvencies would be pooled with existing large plans and share administration.

- Once a plan entered the pool it would stay there. Should the sponsor recover, required payments would be made to the plan. Moving plans back and forth depending on the outcome of insolvency proceedings would introduce unnecessary additional costs.
- The pool would, for the most part, not receive plan contributions, therefore solvency/going concern funding concepts may need to be addressed.

The new pension plans would be federally regulated to simplify the process and ensure all Canadians would be treated equally, thereby creating a single jurisdiction solution.

Benefits and Risks

There are clear benefits to this approach. Putting these plans under the umbrella of an existing large multi-employer plan would enhance returns and gain efficiencies in administration. Pooling the assets is important to the objective of maintaining the pension payments at 100%, since typically, the larger the pool of assets under management the better the returns. Furthermore, existing plans can maintain a more advantageous risk profile than individual distressed plans or even a pool of distressed plans.

Conversely, this approach also adds an element of risk to the plans. While the objective is to grow the plans, there would be a risk that the plans could deteriorate. This risk has to be addressed in the plan design. One way to do this would be to make the original regulator responsible for any loss on a go forward basis. That is, the pension would be moved as is, at the existing funding level and solvency ratio. Any reduction in that solvency ratio would be backstopped by the regulators' jurisdiction. The rationale for this approach is that the regulators allowed the underfunding and are responsible for it.

Insolvency Legislation is the right place for this change

Making the changes under insolvency legislation has a number of advantages:

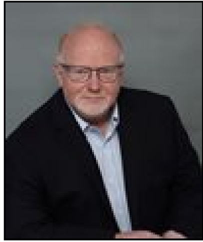
- The event that triggers the problem is the insolvency filing. Pension benefit regulations may be responsible for the funding level, but the insolvency filing turns a potential problem into a real one.
- It is critical to avoid the de-risking of the pension which is current practice. De-risking results in no to low returns through the time the plan is de-risked. The goal of this proposal is to allow the plan to recover to support pension payments of 100% of the commitment. A period of no to low growth seriously impedes this objective.
- Insolvency legislation enjoys paramountcy over pension benefit regulations. A change to insolvency legislation is applicable to all pensions of insolvent companies regardless of the jurisdiction the plan is registered in.
- Insolvency legislation already acknowledges different classes of assets and different treatment of those classes. Pension assets of insolvent companies would become one more.
- Providing an option to opt out gives plan members control over their future financial security. They can go with the new option receiving 100% of their pension payment with some risk, or take their share of the assets as commuted value or an annuity.

This model deserves serious consideration and discussion and sooner rather than later. The economic consequences of the pandemic have started, insolvencies will be occurring. The time to act is now.

Responding to the urgency created by the COVID-19 pandemic, the Canadian Federation of Pensioners has consulted with key sector players -- pensioners, pension sponsors, pension monitors, regulators, insolvency experts, pension administrators and managers, annuity firms and seniors' advocates -- to review this innovative solution to the looming crisis in pension

security.

We are calling on sector stakeholders to work with us to explore this solution and compel the federal government to take action. The time for real pension protection is long overdue.



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Michael is a passionate advocate for pensioners and serves as the President of the Canadian Federation of Pensioners and President of the GENMO Salaried Pension Organization. Prior to retiring in 2009, Michael had a 34-year career with General Motors of Canada, where he was recognized for his leadership in addressing both strategic and tactical issues and delivering solutions that optimally blended business process and technology. During his career, Michael implemented business critical projects ranging from a live to air interactive distance learning network with three studios and 800 downlink sites to GM Canada's first customer relationship management platform. He was instrumental in implementing General Motors Corporation's first stamping plant to exclusively use transfer presses to make major body panels. Michael holds a Bachelor of Industrial Engineering from Kettering University and a Masters of Science in Information Management from Carnegie Mellon University.

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