Pension Investment Association of Canada
Association canadienne des gestionnaires de caisses de retraite

August 31, 2012

Mr. Alban D'Amours
Chair, Committee on the Future of the Supplemental Pension Plans
Régie des rentes du Québec
Case postale 5200
Québec (Québec) G1K 7S9

Attention: André Villeneuve
Secretary of the Régie
Régie des Rentes du Québec

Re: Committee on the Future of Supplemental Pension Plans

Dear Mr. D'Amours:

The purpose of this submission is to provide the views of the Pension Investment Association of Canada ("PIAC") on the future of pensions in Québec as being considered by the Committee on the Future of the Supplemental Pension Plans ("the Committee").

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over one trillion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

PIAC commends the Minister of Employment and Social Solidarity for mandating the creation of the Committee to continue discussions on the future of pensions in Québec, to focus on a pension system viable and efficient for the future that will meet the needs of Québecers.

The pension system today is facing enormous challenges arising from an aging population, low interest rates, market volatility, rising stakeholder expectations, regulatory burdens and the evolution of case law.

While the situation may appear dire to some, solutions are at hand. Governments have the ability to alter the policy underpinnings of the supplemental pension system and thereby alleviate some of the funding and regulatory challenges that plan sponsors and administrators are facing. In this submission, PIAC proposes that the Committee recommend the following to the government of Québec:

1. Existing rules for funding solvency deficits are too stringent. Funding rules require solvency deficits to be eliminated over 5 years. Managing a pension plan for the long-term has become a short-term exercise. To address this we recommend that Québec take steps to ease solvency funding requirements and to address risk asymmetry in the rules regarding surplus entitlement by:

   (a) making the 10 year amortization of solvency deficits a permanent measure;
   (b) continue providing plan sponsors the flexibility to use Letters of Credit but remove or increase the 15% limit on LOCs;
   (c) permitting plan sponsors to establish special purpose accounts ("solvency accounts") that are independent from the main pension trust, that count towards funded status if required and that are insulated from surplus sharing disputes that may relate to previous assets of the plan;
   (d) providing for annual refresh of the deficit amortization to allow annual recognition of any improved funded status, not just deteriorating funded status.

2. Hold pension investments to the standard of a prudent person and eliminate all quantitative limits on investing.

3. Work towards harmonizing pension law across Canada.

4. Allow annuity purchases for retirees by all pension plans, with full transfer of responsibility to the insurer.

5. Allow single-employers to setup target benefit plans which eliminate the employer responsibility for deficits and provide the ability to reduce benefits when necessary and appropriate to ensure long term sustainability.

6. Address risk/reward asymmetry which PIAC believes currently exists, whereby plan sponsors are generally responsible for funding shortfalls but are severely constrained from accessing surpluses. This is the major impediment to not only the funding of private-sector DB pension plans but to their continued existence. Consequently, it is imperative that governments introduce some meaningful, permanent solutions to deal with the risk/reward asymmetry.

PIAC's comments to the Committee in this letter address the key issues facing our pension fund members in Québec, including solvency rules and funding mechanisms such as letters of credit, the extent and invasive nature of some pension regulations, our thoughts on whether Voluntary Retirement Savings Plans (VRSP) will be successful in resolving some of the issues facing pension plans, and recognizing the need to better harmonize pension laws across Canada.

PIAC Views

PIAC is concerned that the number of defined benefit plans is declining significantly across Canada. In general, defined benefit ("DB") pension plans deliver the most cost-effective pensions to retirees. DB pension plans pool both longevity and investment risk and address inflation risk if indexed. Yet, DB pension plans are becoming less and less a feature of the private-sector pension system. Overall coverage of paid workers in Canada by registered pension plans declined from 46.2% in 1977 to 39.3% in 2003. The decline in DB pension plans was more pronounced, with the percentage of plan members in a DB pension plan declining from 92.7% to 81.5% over the same period while for private-sector workers alone the decline was even greater, from 90.6% to 74.2%[1]

PIAC believes that the fundamental reason the number of DB pension plans are declining is due to funding and regulatory challenges. Plan sponsors are experiencing increasing financial pressures from the volatility of pension expense due to low investment market returns, dropping interest rates, conservative solvency valuation assumptions and changes in accounting standards. Recent court decisions regarding partial windups, expenses, asset transfers and surplus (Stelco, Kerry, Transamerica and Monsanto) have created an uncertain and negative legal environment for plan sponsors. The pivotal Supreme Court ruling in the Monsanto case exacerbated the asymmetrical sharing of pension risk between employer and employee groups. Adding to this burden are the onerous requirements for funding solvency deficits. Plans operating in multiple jurisdictions must also contend with the labyrinth of pension law and regulators across the country. This makes plan administration more difficult and costly. Finally, employees, especially younger ones, are not always aware of the benefits and risks of their pension plans. All of the above mentioned points encourage plan sponsors to freeze or terminate their existing DB pension plans, and do not encourage plan sponsors to create new defined benefit plans.

Québec's introduction of the VRSP is a significant step in addressing pension coverage due to its mandatory nature and ease of entry for smaller employers and the self employed. However, as stated in our submission to the Québec Ministry of Finance in May 9, 2012, PIAC believes it is important that the legislative framework and governance be as uniform as possible from one province to another with the objective of minimizing administrative and management costs.

Harmonization will foster greater mobility of the workforce within the country and achieve the main objective of expanding the retirement income coverage of the Canadian population. We encourage the Québec government to consult with the other jurisdictions in Canada, to promote Québec's position on mandatory establishment of VRSPs/PRPP's, as well as to promote uniformity in all legislative and regulatory aspects of this important new pension vehicle in Canada.

[1] B. Baldwin, "Determinants of the Evolution of Workplace Pension Plans in Canada", March 2007.

PIAC believes that in evaluating pension issues in Québec, it is critical to ensure that all parties to a pension plan agree on answers to the following basic questions:

- What is the pension deal for each type of pension plan?
- What is promised?
- Who pays for it?
- Who bears the risk, and what kind of risk?

It is time for the government of Québec, and other governments in Canada, to revamp private-sector pension plan standards. DB pension plan coverage is declining but has not declined as much in Canada as in other nations such as the U.S., U.K. and Australia. Before the trend accelerates, the policy approach to funding rules and other regulatory issues needs to change significantly. The changes that PIAC is recommending will create a more conducive environment for creation and maintenance of DB pension plans and the growth of defined contribution pension plans. The Committee, and the Québec government, have an opportunity to demonstrate leadership in this area.

PIAC is pleased to have the opportunity to contribute to the review of the standards for private-sector pension plans in Québec by the Committee. We would value an opportunity to meet with the Committee to answer any questions on our recommendations.

Yours truly,

Julie Cays
Chair

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