
The Multi-Employer Benefit Plan Council of Canada (MEBCO)

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SUBMISSIONS TO THE PRIVATE PENSION PLANS DIVISION, OFFICE OF THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS (OSFI)

A RESPONSE TO OSFI's CONSULTATION PAPER ON MINIMUM FUNDING DATED JULY 2000

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1. The Multi-Employer Benefit Plan Council of Canada (MEBCO)

MEBCO was established in 1992 to represent the interests of Canadian multi-employer pension and benefits plans (MEPs) with provincial and federal governments regarding proposed or existing legislation and policies affecting these plans. MEBCO is a federal no-share capital corporation, operating on a not-for-profit basis.

MEBCO is representative of all persons and disciplines involved in MEPs, including union and employer trustees, professional third party administrators, non profit or “in-house” plan administrators, and professionals including actuaries, benefit consultants, lawyers and chartered accountants. MEBCO is administered by a Board of Directors consisting of representatives from each of the above groups.

2. Background of MEPs

Over the past quarter-century, labour and management have joined together to develop a response to the problems of delivering quality health services and retirement plans to workers and their families in industries typified by small companies and a mobile work force. There are hundreds of MEPs in Canada covering well over **1,000,000 workers and their families** 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 MEP may be national, regional, provincial or local in coverage. Anywhere from 2 to over 1,000 employers may contribute to a single MEP pursuant to one or several collective agreements.

Collective agreements negotiated by one or more unions establish MEPs and the contributions necessary to finance and provide benefits under these plans. MEPs are “Trust Funds” and are generally administered by a joint board of trustees, comprised of an equal number of trustees appointed by the union(s) and the employers. These trustees are responsible for receiving contributions from employers, paying certain benefits directly to members and their dependants and entering into insurance contracts for the provision of other benefits. In the event that an employer is delinquent in making contributions, the trustees, normally through the union-party to the collective agreement(s), pursue collection proceedings.

Some of the more common forms of **coverage** provided by MEPs include:

- Extended Health and Hospital Care;
- Drug Care;
- Dental Care;
- Vision Care Benefits;
- Sickness and Disability Benefits;
- Life Insurance;
- Retirement Pension Benefits; and
- Retiree Health, Dental and Life Insurance Benefits.

These plans provide **continuous benefits coverage** to workers as they change employment from one contributing employer to another. This **portability or seamless coverage is essential for workers** in mobile, seasonal industries like construction and entertainment. Additionally, most plans allow for the accumulation of revenues and “pay direct” schemes to **protect workers and their dependents during periods of unemployment** not uncommon in many of the industries represented.

EMPLOYMENT PATTERNS

A worker may be employed by a particular employer for only a day, a week, a month or a few months, to work on a specific project, and then move on to work on **another contributing employer’s project**, and thereafter another, etc. Between jobs, he or she might be off work for a day, a week, a month or longer. **A worker may work for several different employers over his or her working life, with periods or unemployment between jobs.**

Without a **central plan covering all of his or her work for multiple employers**, workers could not have ready access to the many necessary benefits provided by MEPs. Frequent changes in employment would make coverage by one employer impossible. Since most employers are small, they simply are unable to maintain a separate benefit plan.

Because of different employment patterns, workers in these industries tend to identify with their union rather than with a particular employer as the central organising force in their work life, a reality long recognised in Canadian labour law. That is, a construction labourer identifies with the Labourers Union, a plumber with the United Association of Plumbers and Pipefitters, etc. rather than with a contractor. Also, workers look to their union for health care and other benefits not provided by the public health care plan.

ECONOMIC ADVANTAGES OF MEPS

MEPs have been made feasible by the **economies of scale** enjoyed by the bringing together of large numbers of smaller employers. Financial savings occur in such areas as administration and purchasing of benefits, which would not otherwise be available to individual employers, particularly small employers. Matters such as the design of these benefits plans are the responsibility of the trustees with professional assistance. This eliminates the need for participating employers to maintain their own plan administration work force. Simply put, MEPs can use the pool of collectively bargained contributions and the pool of covered workers and their families, to negotiate better terms with insurers and others than the individual employer could.

FINANCING OF MEPS

As noted above, MEPs are funded through employer contributions based on hours worked. Workers covered by MEPs are highly sensitive to increases in benefit costs, since any increase would often translate directly into a lower take home pay. Both in Canada and the United States, **these plans were established many years ago as a result of government tax incentives**. More specifically, employers were allowed to deduct from taxable income their contributions to MEPs and **employees were generally not subject to tax on either the amounts of these contributions or the benefits they receive**. Not surprisingly, this has led to a proliferation of MEPs in both countries from which union members and their families have benefited greatly.

3. The Purpose of this Submission

MEBCO has prepared this submission in response to OSFI's *Consultation Paper on Minimum Funding Requirements* dated July 2000. MEBCO supports the premise that members and former members have every reason to expect that the "pension promise" will be fulfilled and that rights of members and former members should be protected. MEBCO supports reasonable initiatives that will better ensure that pension benefits will be delivered to all members and former members. Throughout this submission, the acronym MEPPs will be used to describe multi-employer pension plans.

MEBCO believes that it is appropriate for MEPPs to fund and value pension plans using actuarial assumptions and/or methods that include provisions for adverse deviation within bounds of accepted actuarial practice. However, MEBCO believes that OSFI must recognize funding standards for MEPPs which recognize their unique characteristics. MEBCO would welcome an opportunity to work with OSFI to develop such standards.

This submission does not specifically address the rights of plan members to know the solvency status of the pension plan, as OSFI has announced that there will be consultations with the pension industry regarding additional disclosure requirements in this area. To this end, MEBCO will be pleased to provide commentary on recommendations that will impact MEPPs.

For the purposes of this submission, OSFI's recommendations for amendments to be made to the *Pension Benefit Standards Regulations, 1985 (PBSR)* and other proposals are highlighted in text boxes. MEBCO's recommendations are highlighted in italics.

4. Void Amendments

OSFI recommends the addition of a prescribed solvency ratio for void amendments. This would permit an increase in the benefits only if (a) the additional liability did not result in a solvency ratio below .90 or (b) the employer remitted an additional contribution sufficient to increase the solvency ratio to at least .90.

MEBCO agrees with OSFI that plan beneficiaries expect to receive their full benefit. However, MEBCO opposes the recommendation of a 0.90 prescribed solvency ratio below which amendments to MEPP benefits will be void. The nature of defined benefit pension plans allows for the funding of benefits over a period of future time. This principle should not be changed. There is no reason to distinguish between funding past service benefits resulting from an amendment to a pension plan and funding initial past service benefits in a new pension plan. Therefore, MEPP boards of trustees should continue to be able to promise defined benefit enhancements for prior service, provided that the contribution formulae will adequately fund current service benefits and amortize past service enhancements within a period of not more than 15 years.

MEBCO submits that OSFI's recommendation does not reflect the reality of MEPPs. MEPPs have unique characteristics from single-employer pension plans. A board of trustees, rather than an employer, generally administers a MEPP. Usually, the rate of contribution is negotiated and fixed for the duration of a collective bargaining agreement (or durations of collective bargaining agreements) between a union (or unions) and participating employers. Contributing employers are not a party to the pension plan, and as a result, the obligation of contributing employers is strictly limited to making timely contributions as set forth in the collective bargaining agreement(s). Without modification to reflect the reality of MEPPs, OSFI's recommendation seems to imply that employers would be required to contribute beyond amounts established by collective bargaining. No employer would agree to such a provision, and as such, the retirement security now provided to members of "defined benefit" MEPPs would cease to exist if this recommendation predisposes a MEPP to be wound-up. Employers would absolutely decline to agree to collective agreements that could require employer contributions that could escalate without restriction.

If MEPPs will be required to fund all or most of the up-front cost of all benefit improvements, increases in benefit levels will most likely cease and the retirement income security of Canadians covered by MEPPs will deteriorate. It is as unrealistic to expect a pension plan to accumulate 90% of the needed funds before granting past service enhancements as it is to expect families to save up 90% of the cost of home ownership, with the ability to have only a 10% mortgage.

Such a recommendation could influence unions and employers to radically modify widespread and long-held practices established through past collective bargaining, and freeze or dismantle “defined benefit” MEPPs. As well, the chance of employers agreeing to re-open a collective bargaining agreement before the agreement has expired in order to fund pension contribution increases is very slim.

While “defined contribution” MEPPs could still exist, MEBCO fully supports boards of trustees who offer “defined benefit” plans. In MEBCO’s view, these “defined benefit” plans operate to provide the greatest possible amount of lifetime retirement benefits to those who need income the most...the members nearest the end of their active careers.

Adherence to this recommendation will likely result in lower benefits to pension plan members than could be afforded, if the benefits could be funded over the traditional 15-year time frame.

Moreover, this recommendation assumes that a solvency ratio is the appropriate measure of adequate funding for MEPPs covering thousands of employees and hundreds of employers. MEBCO questions this assumption, unless it is modified. MEBCO acknowledges that if the employer in a single-employer pension plan goes bankrupt, it is important to have a solvency ratio of at least 1.00. However, in the MEPP situation, it is theoretically possible that many employers (let alone only one employer) could go bankrupt where the MEPP has a solvency ratio below 1.00, and no members’ benefits will necessarily be jeopardized.

With regard to OSFI's comment that some MEPPs "experienced declining membership, which resulted in a reduction in contributions", MEBCO notes that "contribution level" is an assumption that must be made by the MEPP's actuary. Like other actuarial assumptions (individually and/or collectively), there should be a margin for adverse deviation. Extended periods of adverse contribution levels should be addressed in a responsible manner by the board of trustees, where typically it would only be a last resort wherein accrued benefits would be reduced. (One potential interim action could involve reduction in the level of future service benefits, and as current collective bargaining agreements expire, negotiating more pension contribution).

With regard to solvency valuation interest rates and other prescribed actuarial assumptions, MEBCO believes that generally, interest rates certainly include sufficient margins for adverse deviations. If OSFI does not similarly hold this belief, MEBCO invites further dialogue on this matter.

Letters of credit from financial institutions are simply not appropriate for MEPPs. Financial institutions would not grant such instruments, and the administrators of the MEPP would have no ability to fund any "call".

MEBCO recommends that MEPPs be exempt from any regulation that does not permit all benefit improvements to be funded over up to a 15-year time frame. MEBCO recommends that OSFI view the actuary and the board of trustees, each acting responsibly within their respective roles, as the best possible protection against a MEPP defaulting on its promises.

MEBCO does not believe that small solvency deficits should trigger annual valuation requirements. Nevertheless, MEBCO accepts the concepts of risk-based supervision, and where solvency ratios are below a threshold (MEBCO suggests 80%), that traditional triennial valuation reports be replaced by annual valuation reports.

5. Solvency Normal Cost and Changing the Amortization Period for Funding a Solvency Deficiency

OSFI recommends introducing a “solvency normal cost” for plans that are not fully funded on a plan wind-up basis and reducing the amortization period for funding a solvency deficiency from the current five years to three years.

MEBCO opposes the application of solvency rules to defined benefit MEPPs due their unique nature. Technically, the only benefit that has been promised is a target benefit. Therefore, technically MEPPs are always solvent. Nevertheless, MEBCO also affirms its opinion that boards of trustees have an obligation not to offer benefits under a MEPP that likely cannot reasonably be delivered. Moreover, solvency rules should not apply to MEPPs as they seldom wind up.

In the alternative, if OSFI takes the position that solvency rules must apply to defined benefit MEPPs then MEBCO opposes the recommendation to reduce the amortization period for funding a solvency deficiency from the current five years to a new three-year rule. In fact, for benefit enhancements, MEBCO reiterates its view that there should be no constraints to funding such enhancements over up to 15-years! Further, in order for there not to be constraints on a MEPP’s ability to offer its current level of benefits, any solvency deficiency should be allowed to be funded using a modified solvency basis.

The modified solvency basis should reflect the funding realities of MEPPs. The basis should include the following factors: (a) an amortization period appropriate to MEPPs for funding a solvency deficiency; (b) no requirement to apply such solvency tests as the “maximum cost” rule; (c) the ability to use expected experience (as detailed in Part 7 of this submission under the heading “Impact on other jurisdictions”); and (d) the ability to use averaging for interest rates, assets and liabilities (as detailed in Part 7 of this submission under the heading “Spot Valuation results”).

As noted earlier, there are different funding realities between MEPPs and single-employer pension plans. It is very difficult, if not impossible, to obtain additional contributions from employers when there is no current collective bargaining, and a three-year period could needlessly force a board of trustees to reduce benefits.

Finally, such a rule would be inconsistent with all other jurisdictions. MEBCO supports a harmonization of regulatory provisions, rather than additional diversity.

MEBCO recommends that MEPPs be exempt from any requirement to fund a solvency deficiency.

In the alternative, MEBCO strongly recommends that MEPPs be exempt from any three-year amortization period for funding a solvency deficiency and that MEPPs be subject to modified solvency rules which accurately reflect the funding realities of MEPPs.

6. Plan Wind-Up

OSFI recommends the addition of a requirement for full funding on plan wind-up and wants commentary on implementing default priority classes for plans that are silent with respect to priorities on wind-up.

Full MEPP wind-ups are rare. In a true wind-up, solvency funding is a concern. MEBCO suggests that boards of trustees are usually cognizant of declining industries and membership (it is extremely rare that an entire industry disappears altogether in a short time frame). MEBCO believes that boards of trustees will avoid taking inappropriate actions, such as unaffordable benefit improvements, in those circumstances. MEBCO further suggests that a plan's actuary, responsible for providing an opinion that the contributions will fund benefits, presents a further degree of protection against foreseeable insolvency.

MEBCO notes that in a MEPP, by its nature, there is no party that would be available to contribute to liquidate an unfunded liability upon full wind-up (although, MEBCO understands that Quebec does have requirements imposed on employers for funding MEPPs on wind-up, MEBCO vigorously opposes these requirements). Given the materially lower likelihood of wind-up for a MEPP versus a single-employer plan, and given the responsibility placed upon a MEPP's board of trustees and the Plan's actuary, MEBCO submits that the lower likelihood of wind-up mitigates against the absence of a "contributor of last resort". Further, such a funding requirement may lead to employers no longer wishing to participate in MEPPs which may have a detrimental effect on MEPP members.

MEBCO supports the position that boards of trustees should be responsible for ensuring that their MEPPs contain plan provisions which specifically address priorities on wind-up. It also supports a legislative requirement that plan documents must specify the distribution of assets on plan wind-up. As a result, default priority classes for plans that are silent with respect to priorities on wind-up would not be required as the priorities would be set out in the plan documentation.

MEBCO recommends that MEPPs be excluded from a requirement for full funding on plan wind-up.

MEBCO recommends that there be a legislative requirement that plan documents specify the distribution of assets on plan wind-up.

7. Additional Solvency Considerations

While MEBCO fully supports the necessity to respect the pension promise and ensure that all reasonable precautions are taken to ensure that plans do not terminate in an unfunded position, MEBCO submits that regulation that inhibits the initiation, continuation and growth of MEPP is not in the public interest. As such, MEBCO suggests in addition to regulation and monitoring federally-regulated pension plans, an equally important aspect of OSFI's mandate must be to support the initiation, continuation and growth of private sector pension plans, including specifically negotiated contribution multi-employer defined benefit pension plans. Therefore, MEBCO suggests that OSFI should refrain from enacting regulation, or encouraging legislation that would curtail the initiation, continuation and growth of private sector pension plans, including requirements that plans fund at unnecessarily conservative levels, or avoid providing beneficiaries with benefits that can reasonably be expected to be delivered.

MEBCO suggests that the proposed provisions with respect to solvency are at odds with the promotion "partnership" role that MEBCO believes can and should be performed by OSFI.

There are several additional issues related to solvency that MEBCO wishes to address:

- **'Spot' Valuation Results**

For an ongoing pension plan, a solvency valuation is essentially an artificial "snap-shot" of the financial position under prescribed assumptions at a point in time in the past. This occurs because it generally takes 4 – 8 months, possibly longer, to assemble data, value liabilities, present results to the board of trustees, complete an actuarial valuation report and file that report with regulators. Expressed another way, by the time "solvency" results for ongoing plans are known, they are out-of-date!

Solvency results, unfortunately, have real meaning only if or when a plan has terminated.

Since results are based upon prescribed valuation assumptions, any variation in such prescribed assumptions from time to time can have a material impact upon the financial position of the plan. The principal prescribed valuation assumption is the “interest rate”, which is based upon the yield available on long-term government of Canada bonds (as at a point in time 2 months prior to the valuation date). While a “market-related” valuation rate is clearly necessary in the event that an actual wind-up has occurred, the potential volatility of such a process is unnecessary and inappropriate for an ongoing plan. *The Pension Benefits Act* of Ontario recognizes this aspect, and permits an “averaging” process over periods of up to 5-years, subject to a commensurate averaging applied to assets.

MEBCO submits that the prescribed valuation basis for MEPPs (and possibly for all plans) permit an averaging of prescribed interest rates over a period of not more than 60-months ending with the valuation date, contingent upon a commensurate averaging applied to assets.

- **Impact on other jurisdictions**

MEBCO supports harmony of pension legislation. MEBCO submits that it is inappropriate that legislation and/or regulation applicable to some Canadian plans is more onerous than that applied to other plans. MEBCO recognizes that while OSFI regulates a relatively small percentage of Canadian registered pension plans, actions taken by OSFI have a significant influence on the various provincial regulators. Therefore, MEBCO is concerned that actions proposed by OSFI and viewed as unnecessary or inappropriate by MEBCO will be replicated in provincial legislation and/or regulation, particularly where application can have the potential for incredibly damaging consequences.

Two provinces have special “grow-in” rules, which provide that any enhanced early retirement rights not vested in members at the valuation date must be valued at “maximum potential liability” for solvency purposes (contingent on a member having 55 “points”, where a point is a year of either “age” or “service”).

Valuing “grow-in” benefits has the effect of appropriating assets that will never be utilized to provide members with benefits as long as a plan is ongoing. By way of an illustration, consider an MEPP with normal retirement age of 65, and in the event of termination of membership, plan terms provides that a former member is entitled to:

- a normal form pension,
- the actuarial equivalent value of a normal form pension for early retirement, or
- portability of the value of a normal form pension.

Plan terms further provide that members who retire can receive a pension without reduction at age 60, or between ages 55 – 60 with a subsidized reduction providing 70% of a “full” pension at age 55.

Plan experience for the ongoing plan demonstrates that the average age at retirement over the past 9 years has not varied by 3-months from age 62.5.

Valuing grow-in benefits means that solvency liabilities would necessarily make the inappropriate and unreasonable assumption that all active members will retire at age 55, or immediately (if older than 55). The consequence is that assets will be appropriated to support possible benefits that have no reasonable likelihood of applying, and thus are unavailable to provide lifetime retirement benefits for the plan members.

MEBCO submits that the prescribed valuation basis for MEPPs (and possibly for all plans) permit an averaging of retirement ages based upon the experience of the ongoing plan, and that in the unlikely event of the plan actually winding-up, benefit entitlements to members active at the wind-up date be based upon the historical averages, not “maximum value” rules. [MEBCO acknowledges that “grow-in” does not apply in federally-regulated plans, but this comment is presented for more general purposes.]

8. Conclusion

MEBCO is concerned that the recommendations from OSFI appear not to acknowledge the unique characteristics of MEPPs, and seem to reflect considerations principally applicable to single-employer pension plans. MEPPs are longer lasting. MEPPs can survive the financial hardships that single-employer situations may not. MEPPs cannot change contributions without collective bargaining, an action that exists only at specific times. MEPPs have no “contributor of last resort”, nor can avail themselves of financial instruments, such as a letter of credit.

While MEBCO acknowledges that members and former members of MEPPs expect that benefit promises will be delivered, MEBCO believes that such expectations will primarily be fulfilled by the responsible actions of the boards of trustees, assisted by their actuarial advisors.

MEBCO is opposed to actions that will impair the growth of MEPPs and their proven place in successfully delivering increasing lifetime retirement income to members and former members. MEBCO believes that limits on the provision of past service benefits without advance funding are inappropriate. MEBCO further believes that any experience deficiency that materializes should be addressed over a lengthier allowable time frame, rather than over a shortened period. MEBCO suggests that the proposals will unnecessarily impair the ability of MEPPs to continue to deliver preferred “defined benefit” pension programs, and as such, are more harmful than helpful. Unmodified, such programs may even cause MEPPs to wind-up in an unfunded position, rather than prevent such a happening!

In the unfortunate event that a MEPP does wind-up without adequate assets to meet benefit promises, MEBCO support a legislative requirement that plan documents address specifically the issue of the distribution of assets on plan wind-up.

MEBCO offers to meet with representatives of OSFI to discuss further all or any aspect of the uniqueness that is a MEPP.