

The Pension Holy Grail: **Can It Be Found?**

By: Paul Owens

Lately, much has been written about the ideal pension system for Canada. One of the biggest problems is the lack of unanimity as to what constitutes an ideal pension/retirement income scheme. The gap between where we are today relative to where we'd like to be is not solvable in one step. So instead, perhaps a more practical solution would be to develop a series of workable changes incrementally that demonstrate progress.

Let's review some of the challenges facing the pension system today:

- Low level of coverage for private sector employees.
- Lack of pension legislation uniformity across Canada that impacts private sector employers under provincial jurisdiction but who operate in several provinces.
- Serious underfunding of Defined Benefit plans as a result of investment losses and steadily declining discount rates used in valuation.
- Tension between financial reporting, which is focused on the short-term, and the long-term liability nature of DB plans.
- Low limits for tax sheltered savings in the maximum annual accrual in DB plans and contribution limits for Defined Contribution plans and RRSPs.

Has anything been done about these problems? In five words: "Yes, but not nearly enough." These unresolved issues have lingered for years. And to add insult to injury, serious underfunding caused by the 2007-09 economic meltdown was preceded by the downturn from the bursting of the tech bubble in 2001-2002.

In response, starting in 2007 and continuing into 2009, we saw pension review commissions, changes in solvency funding requirements, proposed legislation, and a meeting of Canadian finance ministers. On balance, these ad hoc changes were neutral to mildly positive and, in the case of Ontario, represent the first serious response to the '2008 Report on the Expert Commission on Pensions.'

The problem is not with the changes themselves, but the approach taken:

- the changes are piecemeal
- they are not uniform across jurisdictions
- they neither encourage expansion of pension coverage nor continuation of private sector DB plans

It should be noted that some actuaries and international bodies have publicly stated that the Canadian retirement system is really not in as bad shape as is often portrayed, and that it actually compares favorably to most other countries.

Even so, I firmly believe more changes need to be made. As 40 years of legislative history demonstrates, substantive and wholesale changes to Canadian pension legislation are a rarity. Therefore, unfortunately, any change, if it stands any hope of success, does need to be implemented incrementally.

Let's present one change that would prove useful to plan sponsors and attempts to achieve uniformity on an issue already addressed piece-meal in several jurisdictions – solvency valuations. In my view, there is an issue between pension expense and legislatively required actuarial valuations that must be addressed.

Let's begin from the premise that pension expense and actuarial valuations are designed to meet different objectives – financial reporting and benefit security.

The pension expense process examines cost issues over a short period. However, the problem arising with pension expense reporting is the very real possibility that it increases the volatility in annual financial reports due to fluctuations in pension expense reporting.

Turning our attention to legislatively required actuarial valuations, the problem facing plan sponsors is the short time permitted for funding solvency deficiencies.

This is in contrast to the liability stream which is very long-term in nature.

Over the past year, many jurisdictions have lengthened the time allowed to fund solvency deficiencies. This change was linked to somewhat onerous member consent requirements in some jurisdictions. As well, some provinces permit smoothing of assets and liabilities and exclusion of future indexation for solvency valuations. The result is the funded ratio may be higher than what it should be.

A workable solution that simplifies the process and improves transparency is to calculate solvency liabilities without any benefits exclusion, and in recognition of the long-term nature of pension liabilities, allows the shortfall in solvency liabilities to be amortized over 15 years. This is the same period used for funding deficiencies in 'going concern' valuations.

My proposed change doesn't solve all of the problems the Canadian retirement system currently faces. It does, however, demonstrate meaningful progress and offers a tool to make funding of shortfalls in private sector pension plans less onerous. ■

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