Taking a Holiday

The Impact of Employer Contribution Holidays on the Funding of Defined Benefit Pension Plans

June 2005

SHARE
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By Gil Yaron

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THE SHAREHOLDER ASSOCIATION FOR RESEARCH AND EDUCATION is a national not-for-profit organization helping pension funds build investment practices that protect the interests of plan beneficiaries and contribute to a just and healthy society. SHARE works with institutional investors to promote socially, economically, and environmentally responsible investment practices through research, education and advocacy.

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THIS STUDY LOOKS AT THE EFFECT THAT WITHHELD PENSION PLAN CONTRIBUTIONS BY employers has had on the current funding status of pension plans in Canada. Over the past decade, many employers withheld contributions and applied actuarial surplus toward current service costs – otherwise known as taking a "contribution holiday." Between 1994 and 2003, 60 per cent of all federally registered defined benefit pension plans took at least one contribution holiday. These decisions were based on strong investment performance that resulted in plan surplus, and funding rules that encourage employers to forego contributions when a plan reaches a prescribed actuarial surplus.

The consequences of this practice have been significant. Following the bull market of the 1990s, plan sponsors that took contribution holidays in better years found themselves forced to make supplementary contributions or wind up the plan in the aftermath of the market's decline between 2000 and 2002. According to Statistics Canada, there was a 73 per cent increase in employer contributions, from about $7.3 billion to $12.6 billion, between 2000 and 2002, which it attributes to "the recognition by many plan managers that contributions had to increase, or start again, after a period of a contribution holiday, to avoid or at least reduce their unfunded liabilities." This put a strain on the financial resources of companies, limiting the allocation of resources to other activities, such as R&D and infrastructure upgrades. Furthermore, funding rules requiring plan sponsors to make additional contributions to pay off funding shortfalls often proved ineffective. Many companies declared bankruptcy, putting them outside the reach of funding rules and leaving workers and their beneficiaries with little or no retirement income. Other companies were driven into bankruptcy faster because of supplementary funding obligations, or sought amendments to the rules leaving workers at risk (as witnessed with Air Canada).

This study considers the relationship between contribution holidays and plan funding for federally registered and British Columbia registered defined benefit pension plans that remained active as of December 31, 2003. Contribution holidays taken by active defined benefit pension plans between 1994 and 2003 were compared against their respective current funding deficits.

Findings indicate that lost revenue from contribution holidays would have played a significant role in mitigating the current funding deficits for many pension plans assessed on a going-concern basis. Of the 42 significantly underfunded (i.e. going-concern funded ratio of 80 to 89.9 per cent) or extremely underfunded (i.e. going-concern funded ratio of 70 to 79.9 per cent) pension plans in the study, 45 per cent would have completely eliminated their current actuarial deficit if contribution holidays had not been taken.

The study's findings illustrate the disconnect between short-term oriented funding policy decisions respecting employer contributions based on triennial valuations and malleable actuarial assumptions, and the need for a long-term approach to plan funding that takes into consideration long-term variations in markets, interest rates and plan demographics. The report presents a number of possible approaches for addressing this divide. Various recommendations addressing transparency and disclosure of plan information are also offered based on the experience of conducting the study.

Introduction
The Funding Problem

What's the Problem?

SINCE THE FALL OF THE MARKETS POST-ENRON IN 2000, MANY CANADIAN PENSION PLANS have experienced a marked shift from actuarial surplus to deficit. As a result, many have prophesized a pending funding "crisis" with financially-strapped companies and changing demographics making it cost-prohibitive for plan sponsors to meet existing pension obligations and future funding requirements. Consequently, many plan sponsors are already reducing plan benefits (in the case of multi-employer plans), converting or winding up existing single-mployer defined benefit (DB) plans, and refusing to establish new defined benefit plans in favour of defined contribution schemes that offload future risk to plan members and beneficiaries.

Numerous reports released over the past several years have explored the extent of the funding problem facing defined benefit pension plans in Canada. In its paper *Addressing the Pension Dilemma in Canada,* the Certified General Accountants Association of Canada (CGAA) indicates that, based on a sample of 847 pension plans from the MERCER Pension Database, 59 per cent of DB pension plans in Canada were in a deficit position as of December 31, 2003, with an average funding ratio of 0.83.[1] A study conducted by the Bank of Canada using the MERCER data from the same period provides an only slightly better assessment.[2] Analyzing data from 850 pension plans – representing approximately 30 per cent of the DB pension plan assets registered in Canada – the study found that two-thirds of assets were in moderately underfunded plans (i.e. solvency ratios between 0.9 and 0.99). Ten per cent of pension plan assets were in severely underfunded pension plans with solvency ratios of 0.8 or lower. According to a C.D. Howe Institute study by pension consultant Keith Ambachtsheer, 68 large DB plans experienced a corresponding deterioration in their aggregate funding ratio by about 30 per cent during this period.[3] An earlier report by the Dominion Bond Rating Service found that 25 per cent of pension plans were under 70 per cent funded as of December 31, 2002.[4]

These findings generally accord with the figures provided by the Office of the Superintendent of Financial Institutions (OSFI), the regulator responsible for overseeing federally registered DB pension plans. According to its 2003-2004 Annual Report, "Estimated solvency ratios… as at December 31, 2003, showed that approximately 53% of all defined benefit plans supervised by OSFI were underfunded (solvency ratio less than one), meaning their estimated solvency liabilities exceeded assets, compared to 47% as at December 31, 2002. Over half of these were underfunded by more than 10%."[5]

What's Causing the Problem?

Pension underfunding is attributable to three factors: poor investment returns, low interest rates and inadequate contributions. The majority of debate over the funding issue has focused principally on the first two factors.

The gains experienced from increased investment returns in recent years have been offset by low interest rates. According to OSFI's 2003-2004 Annual Report:

> The overall condition of Canadian pension plans improved slightly during 2003-2004. Strong performance in equity markets helped the plans' funding situation; however, lower interest rates resulted in a substantial increase in plan liabilities. The net result, based on solvency testing conducted by OSFI as at December 2003, was an overall average improvement of about 2% in solvency ratios over the previous year. Despite this positive development, many pension plans, due to poor market performance over the last few years, have little in the way of a funding cushion, rendering them vulnerable to potential adverse changes in economic conditions affecting their sponsor or financial markets.[6]

Moreover, sustained strong investment returns are unlikely to solve the problem. According to the CGAA report, a 30 per cent rise in the stock market will not correct the current funding imbalance, assuming

CASE STUDY

Central Heat Distribution Limited

Central Heat Distribution Limited is a private B.C. company created in 1991 through the amalgamation of Saturna Holdings Ltd. and Central Heat Distribution Limited. The company provides heat to more than 100 buildings in Vancouver's downtown core, including B.C. Place, General Motors Place, the central library, major hotels and the Ford Centre, through approximately 10.5 kilometres of high-pressure steam pipes.

As of December 31, 2002, the company's pension plan had a funding ratio of 0.7961 with an actuarial deficit of $371,400 on a going-concern basis.

Between 1994 and 2003, the employer took eight contribution holidays totaling $339,811. Total revenues from contribution holidays including interest totaled $411,895 or 110.9 per cent of the plan's current funding deficit.

current average asset allocations where two-thirds of a plan's portfolio is in common shares.[7] In its report, the CGAA states that a pension plan that is currently 80 per cent funded would need to generate an investment return of about 10 per cent per annum for the next five years to eliminate the existing deficit.[8] For pension plans that face a funding deficit of 30 per cent or more – a quarter of all pension plans – the CGAA estimates it would take eight years of double-digit investment returns to remedy the current deficit.

In his article on the funding status of corporate DB pension plans in Canada, Jim Armstrong from the Bank of Canada demonstrates why reliance on investment returns is not sufficient to address the funding crisis facing Canadian pension plans.[9] Applying a "synthetic" index that models the impact of monthly market returns on a typical Canadian DB pension plan (the Watson Wyatt Pension Barometer), Armstrong demonstrates how the funding status of the average plan improved only marginally in 2003 despite very strong equity markets. Armstrong reasons that the relatively small improvement in the funding ratio – in spite of very robust markets in 2003 – can be attributed to an increase in liabilities due to declining interest rates, as well as the strong Canadian dollar dampening realized returns on U.S. assets.

The pension industry has cited myriad other factors that have contributed to the current funding malaise. These include investing in inappropriate high-risk vehicles, using aggressive actuarial assumptions, demographic shifts, uncertainty about surplus ownership, and strict minimum funding rules.[10]

The issue of aggressive actuarial assumptions has been the subject of a recent commentary in the Economist magazine. One article observed that, by virtue of the vagaries of actuarial science, "at the stroke of an actuary's pen a company can make heroic assumptions about the returns its pension assets will earn and so the rate at which its own liabilities will grow in future, allowing it to claim that the pension-deficit problem is manageable."[11] In a further article, the Economist points to the "potential for mischief." "This potential exists because companies have great flexibility in measuring the size of pension obligations and assets, and hence the pension deficits or surpluses that feed into profits."[12] This practice was demonstrated in a recent study of 3,247 company pension plans which found that from 1991-2000, firms tended to boost their pension-return assumptions the year before buying a company, or before their chief executive exercised his stock options.[13]

CASE STUDY

Gorman Bros. Lumber Ltd.

Gorman Bros. Lumber Ltd. is a B.C.-based company established in 1951 and located in the South Okanagan. With more than 250 employees, the company's website notes "this steady workforce has established a strong base on which to build."

As of the latest actuarial report dated December 31, 2002, the company's pension plan had an actuarial deficit of 20.09 per cent. The company took six contribution holidays between 1994 and 2003 totaling just under $1 million in lost revenues and interest and accounting for more than 82 per cent of the actuarial deficit calculated as a going concern.

The Role of Withheld Employer Contributions

Clearly, the various factors identified above have a continuing influence on the health of Canadian pension plans. However, the debate has given relatively little attention to the effect of employer contribution holidays on plan funding. The issue was highlighted by Towers Perrin in its White Paper on Canada's retirement system:

> Increasingly, funding policy is concentrating on avoiding having to make contributions – both by directing increasing proportions of a plan's investment portfolio to mismatched categories that have historically provided higher long-term returns and by deferring cost through pre-recognizing the expected higher returns from equity investments in the discount rate used to determine the plan's liability.[14]

In other words, employers are choosing to invest in higher-risk vehicles and apply aggressive interest rate assumptions to avoid making contributions to the pension plan.[15]

During the heyday of the 1990s, many Canadian DB pension plans found themselves in a surplus position.[16] Plan sponsors often elected to apply the actuarial surplus to fund current service costs instead of

CASE STUDY

Aliant Inc.

Aliant Inc., established in 1999 through a merger of four smaller entities, currently maintains three active pension plans. The TSX-listed company provides communications products and services to Eastern Canada. It has more than 10,000 employees.

The company's 2003 annual report boasted that the company increased its common dividend by 10 per cent in 2003, raising the annual rate to $1.10. "Our strong financial position has allowed us to reward investors with regular dividend increases." (p. 1)

Yet, the company reported a funding deficit in its pension plans of $234 million in that same year, down from $298 million in 2002. The worst case involves Aliant's Newfoundland Telephone Company Limited Employees Pension Plan. As of December 31, 2002, it reported an actuarial deficit of 29 per cent. Aliant Inc. has taken four contribution holidays (1994, 1997, 1999, 2002) since 1994. For the pension plan this amounts to approximately $69 million in missed contributions and interest – equal to 16.92 per cent of the plan's deficit in 2003 (see Table 2). No improvements have been made to the plan since 1994.

Following a five-month strike in 2004, the company and workers entered into a new collective agreement. While no funding commitments were made under the agreement, the company has made subsequent contributions to the plan. The agreement allows for a one-quarter per cent increase in allowable employee contributions. New Brunswick employees that transferred into a defined contribution plan a decade earlier where also brought back into their defined benefit plan at the company's expense. All new employees will be enrolled in a defined contribution plan.

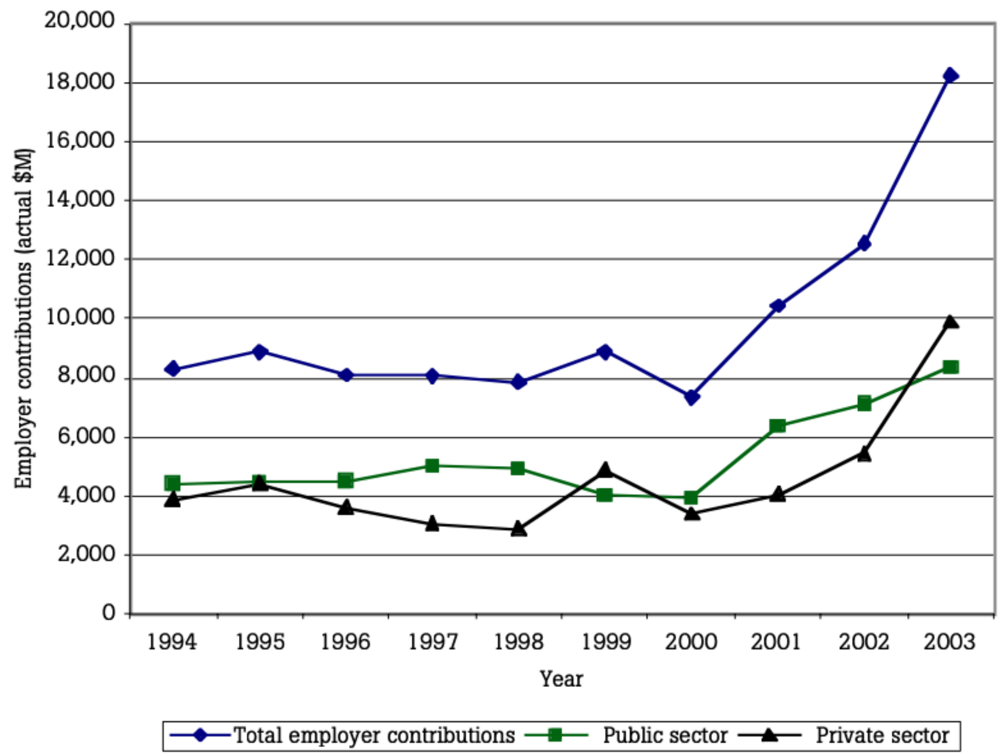
Standard and Poor's Corp. included Aliant on its watchlist "for further monitoring" in 2003 along with 16 other Canadian companies because of concerns about pension deficits.

making contributions to the plan, or they ceased making contributions in response to limits on allowable surplus imposed by the *Income Tax Act*. Statistics Canada cites a 73 per cent increase in employer contributions, from about $7.3 billion to $12.6 billion, between 2000 and 2002 (see Chart 1), which it attributes to "the recognition by many plan managers that contributions had to increase, or start again, after a period of a contribution holiday, to avoid or at least reduce their unfunded liabilities."[17]

Some plan sponsors also abuse the practice of withholding employer contributions. OSFI documents that in 2003/2004, 16 federally regulated pension plans continued to take contribution holidays when they were aware that they might no longer be in a surplus position (see case studies for Aliant Inc. on page 10 and Air Canada on page 12).[18] While these plans resumed their contributions following OSFI's enquiries, the regulator's findings raise concerns about employers' contributions, as well as policy and enforcement practices related to contribution holidays.

In addition, results from a forward-looking five-year study conducted by the CGAA found that solvency ratios for plans with a surplus decreased from 112 per cent as of December 31, 2003 to 108 per cent as of December 31, 2008.[19] The study used a baseline scenario that assumed the continuation of the current low-inflation environment over the project and a representative asset mix of 57 per cent equities (domestic and foreign) and 43 per cent fixed-income assets. This decline is attributed to some plan sponsors applying a

Chart 1: Annual Employer Contributions, 1994 to 2004



Source: Statistics Canada, CANSIM Table 280-0004: Trusteed pension funds, revenues, expenditures and net income, by private and public sector funds, quarterly (dollars).

CASE STUDY

Air Canada

Air Canada's financial woes are now common knowledge. Air Canada reported that six company pension plans – five acquired through its acquisition of Canadian Airlines – had varying actuarial deficits as of their latest 2003 valuations.

Less well known is Air Canada's history of contribution holidays. Between 1994 and 2003 – even after Air Canada knew of its financial crisis – the corporation took between one and three contribution holidays for each of its six plans. In the worst case, the company took contribution holidays in 1999, 2000 and 2003 totaling $24.3 million with respect to one plan with a critical funding deficit of 21 per cent. Contribution holidays between 1999 and 2001 plus lost interest would have offset the current deficit by 17.83 per cent. This does not include the additional holiday taken in 2003.

Concerns regarding Air Canada's solvency came to light in 2002, but prior to that the health of the company's pension plans should have been called into question. The accrued benefit obligations for company pension plans that were underfunded in 2000 was $1.606 billion compared to assets of $1.116 billion – a deficit of $490 million. The airline's pension liabilities increased to $2.049 billion in 2001 with assets of $1.411 billion. The result was an increased deficit of $638 million. Yet, employer contributions in these years decreased from $60 million in 2000 to $39 million in 2001, even as the number of employees increased 19 per cent to 37,476 from the previous year.

According the company's most recently published amended financial statements dated April 2, 2004, OSFI has directed Air Canada to remit contributions approximately equal to the contribution holidays taken in 2001 and to cease taking any future contribution holidays. Air Canada also subsequently contributed 2003 current service costs pursuant to court order. OSFI further directed Air Canada to prepare and file new actuarial valuations as at January 1, 2003, which the company indicated might trigger additional funding obligations.

	Date of most recent valuation	Funding ratio	No. of CHs	CH years	Lost revenue from CHs	Lost CH revenue as % of current deficit
Air Canada Pension Plan	01/01/2003	0.99	4	1997, 1999, 2001, 2003	$286,504,811	6.15%
Pension Plan for Pilots, as Represented by the Air Line Pilots Association International, of Canadian Airlines International Ltd.	01/01/2003	0.94	2	2001, 2003	$54,277,951	6.27%
Pension Plan for Cabin Personnel, as Represented by the Canadian Union of Public Employees of Canadian Airlines International Ltd.	01/01/2003	0.93	3	1999, 2001, 2003	$32,764,866	9.43%
Pension Plan for Technical Services and Clerical Employees, as represented by the IAMAW, of Canadian Airlines International Ltd.	01/01/2003	0.91	3	1999, 2001, 2003	$46,858,638	8.41%
Pension Plan for Dispatch Employees, as Represented by the CADA, of Canadian Airlines International Ltd.	01/01/2003	0.87	1	2003	$538,714	3.59%
Pension Plan for CAW Members Employed by Canadian Airlines International Ltd.	01/01/2003	0.79	3	1999, 2000, 2003	$60,322,634	17.83%

portion of their surplus to cover current service costs and provides one illustration of how contribution holidays can influence the funding status of a pension plan.[20]

The concern with current policy and practice is that employers can withhold contributions when times are good (with no obligation to apply savings towards alternative measures that benefit employees), and subsequently cut benefits, convert or wind up the plan when insufficient funds are available to meet a real or actuarial deficit. Depending on whether the plan has a solvency deficit or a deficit on a going-concern basis, pension regulation does require plan sponsors to make additional contributions to pay off funding shortfalls within a prescribed period of time. However, this policy has proven inadequate in the boom and bust conditions of the past business cycle. Companies declaring insolvency and bankruptcy with under-funded pension plans have become a common occurrence. In such instances, existing regulations can do little to assist employees facing the prospect of receiving a fraction of their promised pension.[21] Employees should not have to suffer the consequence of benefit cuts and risk sharing arrangements because their employer took contribution holidays in richer times.[22]

The purpose of this study is to further investigate the relationship between contribution holidays and plan funding. Specifically, it seeks to assess the degree to which employer contribution holidays have affected the funding levels of DB pension plans that are currently reporting an actuarial deficit, and to make recommendations for reforms to current policy and practice.

The following section provides a brief introduction to the concept of the contribution holiday and the rules governing its application and use. Section three details the methods used in conducting the study. Section four analyzes the study's findings, and the final section discusses some of the outstanding issues influencing plan funding and provides related recommendations for policy reforms.

Contribution Holidays

What is a Contribution Holiday?

Pension legislation in all Canadian jurisdictions requires employers to fund the pension plan in accordance with prescribed tests and standards for solvency by way of contributions toward current service costs and any deficits.[23] In most jurisdictions, the employer may apply surplus, where it exists as determined by the plan's actuarial valuation, to cover contributions for current service costs. The plan's actuarial valuation determines the employer's actual contribution level, which lies somewhere between the amount of current service costs and the maximum deductible contribution, taking into consideration any surplus. Where the actuarial surplus exceeds current service costs, employers may elect to not make contributions and apply the surplus to the current service costs. This is commonly referred to as a "contribution holiday."[24]

One's view on the practice of employer contribution holidays depends on which of three competing theoretical approaches one takes with respect to the ownership of plan assets. The **accounting/economic approach**, largely endorsed by employers, treats pension assets and liabilities as corporate assets and liabilities. Plan members are secured creditors to whom pensions are owed. Accordingly, the employer is required to fund any deficit and is entitled to any surplus in the plan.[25] In this approach, the application of surplus to current service costs amounts to a reallocation of corporate assets on the balance sheet and is independent of any obligations owed to plan members and beneficiaries as secured creditors.

In contrast, the **judicial/legislative view** holds that pension assets are legally distinct from corporate assets. The pension plan is managed as a trust by fiduciaries for the benefit of plan members, not shareholders, while the shareholders are responsible for deficits. In the instance of a contribution holiday, the employer withdraws no money from the trust. Taking a contribution holiday represents neither an encroachment on the trust or a reduction of the promised benefit.[26] The application of surplus to cover current service costs is the abstract application of actuarial surplus (i.e. surplus identified in the plan's actuarial valuation), not actual surplus since the latter does not crystallize until the plan is wound up.

In the case of negotiated cost plans, a third perspective is the **worker approach.** This view holds that employer contributions constitute the deferred wages of workers that have been determined through the collective bargaining process. Employers are contractually obligated to contribute these sums to the pension plan regardless of its funding status. Existing surplus is owned by the plan membership and may not be used by the employer to pay current service costs. Rather, actuarial surplus should be applied in other ways for the benefit of plan members and beneficiaries. The employer remains contractually obligated to continue to make contributions regardless of the ability of the pension plan to meet the pension promise.

These approaches continuously come into conflict and form the basis for much of the existing disagreement about the practice of contribution holidays and other pension funding issues.

When May an Employer Take a Contribution Holiday?

Employers desire to take contribution holidays for various reasons. Contribution holidays allow employers to reallocate contributions to other areas of the company's operations. They also allow the employer to retain ownership of the monies withheld in light of continuing uncertainty over the ownership of surplus. Finally, contribution holidays can be seen as part of the actuarial funding process, and a benefit to the employer that compensates for the employer's acceptance of the financial risks of running a defined benefit pension plan.

An employer's ability to take a contribution holiday is governed by the terms of the pension plan's provisions. As discussed earlier, the judicial/legislative approach treats pension plans as classic trusts subject to trust law. The trust may reserve any power to itself that it wishes provided that the reservation is made at the time that the trust is created. Consequently, contribution holidays are not permitted in instances where the trust agreement explicitly requires that the employer make contributions to the plan.[27]

The Supreme Court of Canada has stated that in the absence of clear direction in the plan's trust agreement, the ability to take a contribution holiday may be implied from the terms of the employer's contribution obligation.[28] Specifically, the existence of a prescribed formula for calculating the contribution obligation has been held to imply that the employer may not take a contribution holiday. However, where the provisions governing employer contributions refer only to the use of actuarial calculations, the use of standard actuarial practices, which includes the application of surplus to covering the employer's current service costs, are presumed.

Pension legislation applies only to the extent that it explicitly supercedes the terms of the trust agreement or where the trust agreement is silent on the matter.[29] Accordingly, many Canadian jurisdictions have introduced regulatory frameworks that govern the taking of employer contribution holidays subject to the terms of the trust agreement. These frameworks vary in both scope and content. At the federal level, pension regulations stipulate that any surplus must either be left in the fund or applied to increasing benefits or reducing employer contributions after addressing any unfunded liabilities or solvency deficiencies.[30] Disclosure to plan members and beneficiaries is not required. Ontario permits contribution holidays under similar circumstances with no disclosure to plan members required.[31] Alberta's *Employment Pension Plans Regulations* permit the reduction of employer contributions in the event of a surplus provided that the plan's provisions do not prohibit the practice.[32]

British Columbia's pension legislation provides the most comprehensive framework governing employer contribution holidays.[33] The plan administrator may voluntarily take a contribution holiday if the plan has a surplus of more than 5 per cent of plan liabilities.[34] The contribution holiday may not exceed an amount equal to the excess surplus above 5 per cent of plan liabilities amortized over five years, and the contribution holiday may not reduce the plan's surplus to an amount equal to less than 5 per cent of plan liabilities.[35] If the plan administrator elects to take a contribution holiday, written notice of the intention must be provided to the Superintendent of Pensions, the plan members and beneficiaries, advisory committee members and any relevant union. Notice must also be provided in the annual statement to members and simultaneously to former members receiving benefits. The regulations also stipulate what information the notice must provide.

The *Income Tax Act* (*ITA*) provides an incentive for employers to take a contribution holiday once the plan has achieved a prescribed actuarial surplus. In principle, contributions made to the pension plan are tax-deductible, providing an incentive for employers to contribute. Section 147.2(2)(d) of the *Income Tax Act* eliminates this deduction for contributions where a plan's surplus assets exceed the lesser of (a) 20 per cent of the amount of actuarial liabilities apportioned to the employer, and (b) the greater of two times the estimated amount of current service contributions or 10 per cent of actuarial liabilities apportioned to the employer.[36] However, it is important to note that the *ITA* does not require employers to take a contribution holiday under these circumstances. The courts have stated clearly that the *ITA* may prevent, but does not prohibit, employer contributions when a plan reaches the prescribed surplus. In the words of one court, "...tax considerations cannot alter the structure of a trust to the detriment of the rights of the beneficiaries... [The limitations imposed by the *ITA* provide a] feeble excuse and not a reason for the taking of the contribution holidays."[37] In that instance, the court cited with approval other approaches available for surplus allocation, including the provision of employee contribution holidays, indexing existing and future pensions to increase the liabilities and decrease the surplus, and refunds to employees. The common restrictive interpretation of the *ITA* is more likely a consequence of mandatory language in many plan trust agreements that often requires the plan sponsor to withhold contributions under the conditions prescribed by the *ITA*. In short, the *Income Tax Act* merely provides a threshold at which tax will not be deductible for contributions. It does not mandate how such funds are to be otherwise treated. It is up to the parties responsible for determining and administering the terms of the plan to set a contribution policy that balances the potential consequences of withholding contributions and the additional commitments resulting from improving benefits.

Study Methodology

THE OBJECTIVE OF THE STUDY WAS TO CONSIDER THE DEGREE TO WHICH MISSED contributions resulting from employer contribution holidays taken between 1994 and 2003 would have offset current actuarial deficits among active defined benefit pension plans.

The study sample included all DB pension plans that satisfied the following four criteria:

- The plan had more than 10 plan members;
- The plan was registered throughout the period 1994 to 2003;
- The plan remained active as of 2003; and
- The plan was underfunded on a going-concern basis as of its most recent valuation (i.e. had a funding ratio of < 1.0).

To obtain the data, freedom of information requests were initially made to Statistics Canada, and to federal and provincial pension regulators. The following information was requested for all underfunded DB pension plans:[38]

- Name of the plan;
- Current status of the plan (e.g. active, terminated);
- Date of plan registration;
- Type of plan (e.g. DB, hybrid);
- Dates of all actuarial valuations submitted between 1994 and 2003;
- Funding ratio as reported in the most recent valuation on a going-concern and solvency basis;
- Actuarial value of the plan's assets and liabilities as reported in the most recent valuation on a going-concern and solvency basis[39];
- Current amount of the plan's actuarial deficit on a going-concern basis;
- Years where the employer took a contribution holiday and the amount of each contribution holiday; and
- Net employer contributions.

Data was ultimately obtained from pension supervisory authorities as submitted by pension plans in their most recent actuarial valuation reports between 2000 and 2003.[40] Only data obtained from the federal and British Columbia pension authorities provided sufficient detail for the purposes of the study (see discussion of access to data in section five).

In addition, aggregate data on pension plan funding was obtained from the most recent annual reports of federal and provincial regulators where such reports were publicly available.[41]

Responses to requests for data were inconsistent. Statistics Canada denied a request for information on the basis that discrete information collected by Statistics Canada is confidential and protected by statute. The federal Office of the Superintendent of Financial Institutions (OSFI) provided all the information requested. The Financial Institutions Commission in British Columbia provided the information subject to a nominal charge for preparing the records. Information provided by Alberta, Manitoba, and Ontario was incomplete and insufficient for the purposes of the study.[42] Manitoba and Ontario refused to provide names of individual pension plans due to confidentiality concerns. Due to technical limitations in how the province tracks information, Ontario provided separate files containing descriptive information and funding information. However, Ontario's refusal to provide plan names or other plan identification made it impossible to complete the cross-referencing of the data necessary for the study. All other jurisdictions either refused to provide the information for reasons of confidentiality or did not respond to the freedom of information requests. Consequently, only data for federal and B.C. defined benefit pension plans were used in the study.

The funded ratio of the pension plan on a going-concern basis was used to assess the ability of the plan to meet its liabilities on an ongoing basis.[43] Specifically, the plan's actuarial assets were divided by its accrued actuarial liabilities based on the assumption that the plan is a going concern. Going-concern data was used because the purpose of the study is to better understand the implications of contribution holidays on the long-term health of active pension plans and to accord with methodologies of other studies.[44]

A plan with a funded ratio of less than 1.00 has an unfunded liability. Plans were ranked based on the level of funding deficit. Applying OSFI's terminology, plans with a funding ratio of less than 0.8 were considered "extremely underfunded." Those with a funding ratio between 0.8 and 0.89 were deemed "significantly underfunded" and those between 0.9 and 0.99 were identified as "moderately underfunded."

To assess the effect of contribution holidays on the current funding of each pension plan, the total value of lost revenue from contribution holidays was calculated using the following formula:

$$A = (((CH_1 \text{ x } (1+i_n)\text{^}0.5))*(1+i_{n+1}\text{^}1))*\ldots) + (((CH_2 \text{ x } (1+i_n)\text{^}0.5))*(1+i_{n+1}\text{^}1))*\ldots) + \ldots$$

where	A	=	total lost revenue
	CH	=	value of the contribution holiday
	n	=	year in which the contribution holiday was taken
	i	=	annual median rate of return for pooled balanced pension plans for each year over time.[45]

Both complete and partial contribution holidays were included in the calculations. The value of total lost revenues from contribution holidays (A) was divided by the plan's current actuarial deficit to assess the relationship between the two values. The results were also analyzed to determine the number of contribution holidays taken by each plan and the total lost income related to all contribution holidays taken as a percentage of the plan's current actuarial deficit.

The study did not take into consideration benefit improvements made by certain pension plans during the study period.

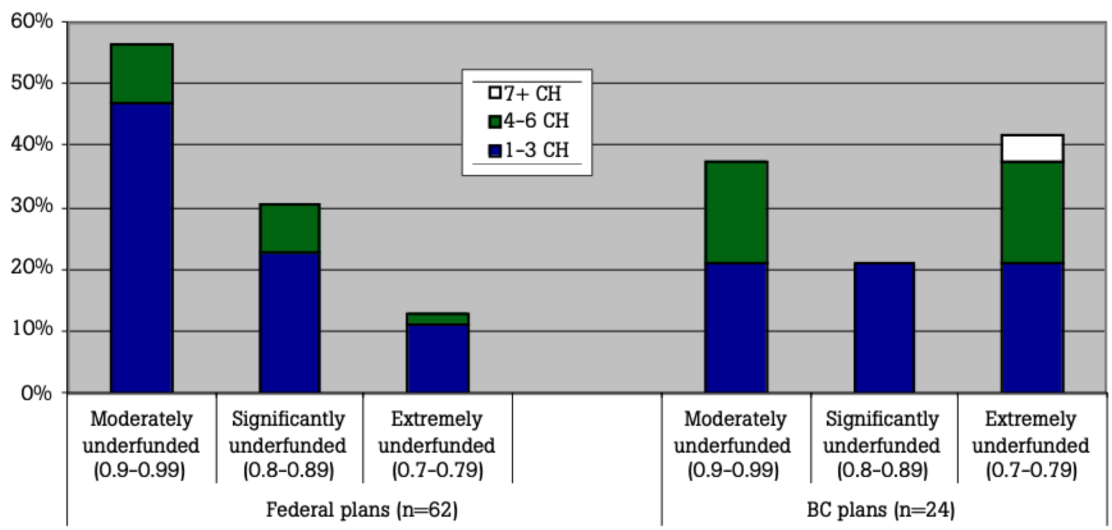
While the study attempted to evaluate the impact of contribution holidays on pension plans, information was not available through the regulators to assess the reasons employers took contribution holidays in each instance. As mentioned above, the *Income Tax Act* provides an incentive for employers to take a contribution holiday if a plan has reached a prescribed actuarial level of surplus. Pension legislation in different jurisdictions also sets different minimum surplus thresholds below which employers may not take contribution holidays. Furthermore, plan sponsors may not want to exercise the alternative of applying plan surplus towards enhancing benefits because of concerns about meeting the associated long-term liabilities.[46]

Analysis

ANALYSIS OF DATA FROM FEDERAL AND BRITISH COLUMBIA REGULATORS INDICATES that lost income from contribution holidays could have played a significant role in mitigating the current funding deficits of many pension plans.

OSFI reports that there were 350 federally registered DB pension plans representing some 367,000 plan members and beneficiaries as of December 30, 2003. Of those, 60 per cent took at least one contribution holiday between 1994 and 2003. As of December 30, 2003, 110 plans were active and underfunded based on each plan's most recent actuarial valuation report. Fifty-six per cent of these took a contribution holiday at least once during the study's timeframe.

Chart 2: Percentage of Active Underfunded Defined Benefit Pension Plans That Took Contribution Holidays Between 1994 and 2003, by Funding Range

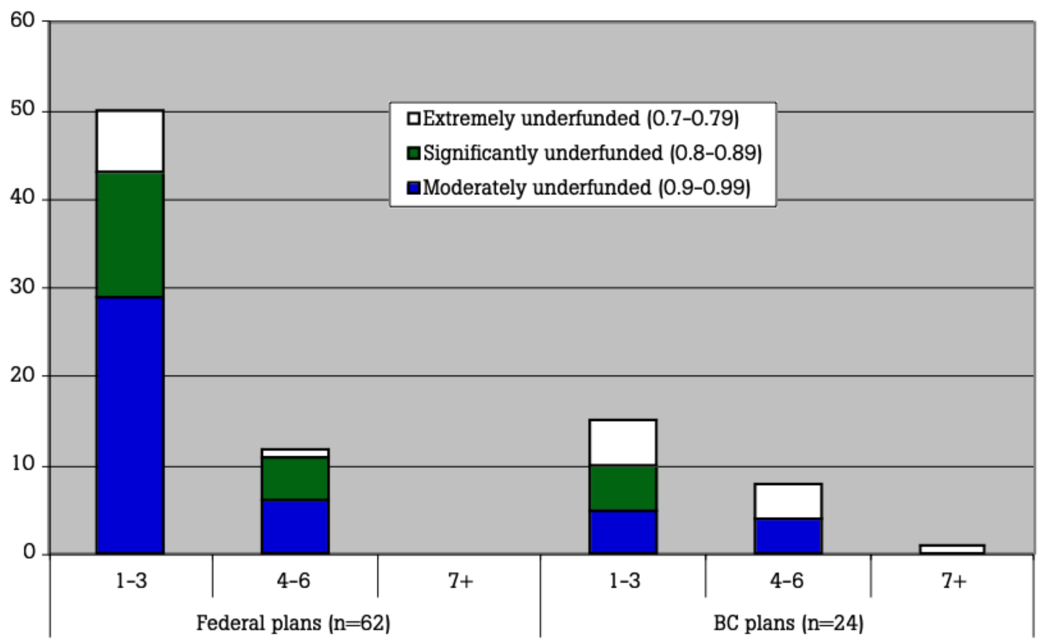


A smaller proportion of underfunded DB pension plans in British Columbia took contribution holidays during the past decade; however, the results are still significant. Of the 59 active registered DB pension plans that were underfunded as of their most recent actuarial valuation report, 41 per cent took a contribution holiday at least once between 1994 and 2003.

Amongst those federally regulated underfunded plans that took contribution holidays, 13 per cent were extremely underfunded, 30 per cent were significantly underfunded and 57 per cent were moderately underfunded (see Chart 2). Each took between one and six contribution holidays over the past decade (see Chart 3). There was no observable relationship between the number of contribution holidays taken and plan funding ratios. The relative distribution of moderately, significantly and extremely underfunded plans was essentially the same regardless of the number of contribution holidays taken. The most egregious case is the Newfoundland Telephone Company Limited Employees Pension Plan – one of four plans sponsored by Aliant Inc. The company took four contribution holidays over the 10 year period, while the plan reported being only 71 per cent funded as of its last valuation report in December 2002. These lost contributions, with interest, would have contributed almost $69 million and reduced the plan's current deficit by just under 17 per cent (see case study for Aliant Inc. on page 10 and Table 1).

The situation amongst underfunded B.C. pension plans was more acute. While fewer underfunded pension plans took contribution holidays, more of those that did had extreme funding deficits. Of the 24 underfunded plans that took contribution holidays, 37.5 per cent were extremely underfunded, 25 per cent were significantly underfunded and 37.5 per cent were moderately underfunded (see Chart 2). Pension plans

Chart 3: Number of Active Underfunded Defined Benefit Pension Plans, by Number of Contribution Holidays Taken Between 1994 and 2003



in this class took between one and eight contribution holidays with most taking five or less (Chart 3). Active underfunded B.C. pension plans took significantly more contribution holidays on average than their federal counterparts (see Chart 4). However, as with federal plans, no relationship was observed between the number of contribution holidays taken by B.C. plans and the degree of funding deficit (see Chart 3). The most stunning example was the Pension Plan for Employees of Central Heat Distribution Limited and Subsidiaries, which reported an actuarial deficit of 20.39 per cent in its December 2002 valuation report, and took eight contribution holidays between 1994 and 2003. With interest, those missed contributions would have satisfied 111 per cent of current actuarial deficit assessed on a going-concern basis (see case study for Pension Plan for Employees of Central Heat Distribution Limited and Subsidiaries on page 8 and Table 2). Similarly, the Gorman Bros. Lumber Ltd. Pension Plan for Salaried Employees took six contribution holidays during the same period despite a current actuarial deficit of more than 20 per cent (see Gormas Bros. case study on page 9 and Table 2).

The study's results find no correlation between the health of pension plans on a going-concern basis and whether plans took contribution holidays. As Chart 5 illustrates, the percentage of underfunded plans that did not take contribution holidays was sometimes greater than those that did take contribution holidays between 1994 and 2003.

However, the findings do reveal that current funding shortfalls for underfunded pension plans could have been significantly ameliorated by lost revenue from missed contributions and interest over this 10 year period. Of the 42 significantly or extremely underfunded pension plans in the study, 45 per cent would have completely eliminated their current actuarial deficit if contribution holidays had not been taken (see Chart 6).[47] For example, the Pension Plan for the Employees of the J.P. Morgan Bank of Canada with a funded ratio of 0.63 as of its most recent actuarial valuation in January 2003 would have offset its current actuarial deficit by 109.2 per cent (see Table 1).

Chart 4: Average Number of Contribution Holidays Taken by Pension Plans Between 1994 and 2003 by Funding Range

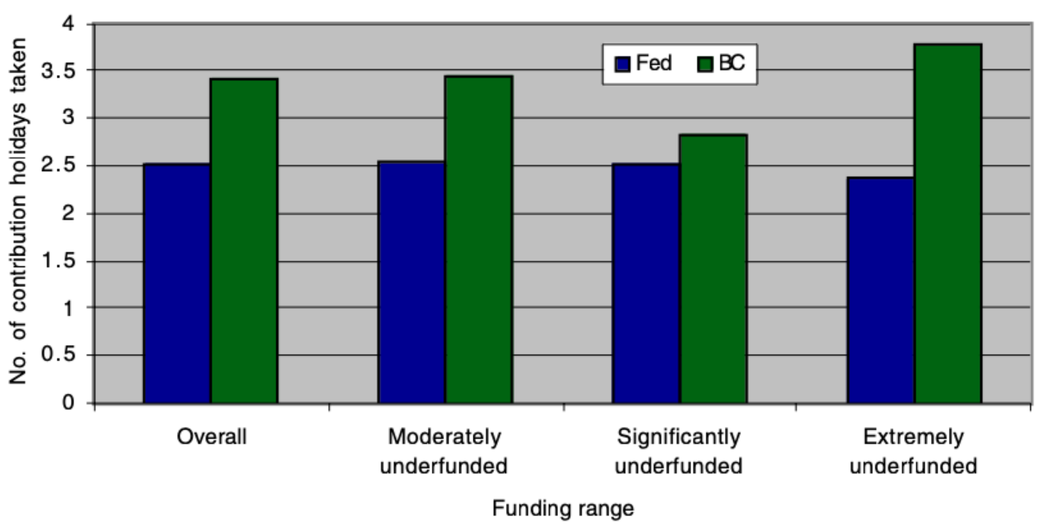


Chart 5: Comparison of Funding Levels of Underfunded Pension Plans That Took Contribution Holidays Between 1994 and 2003 and Those That Did Not

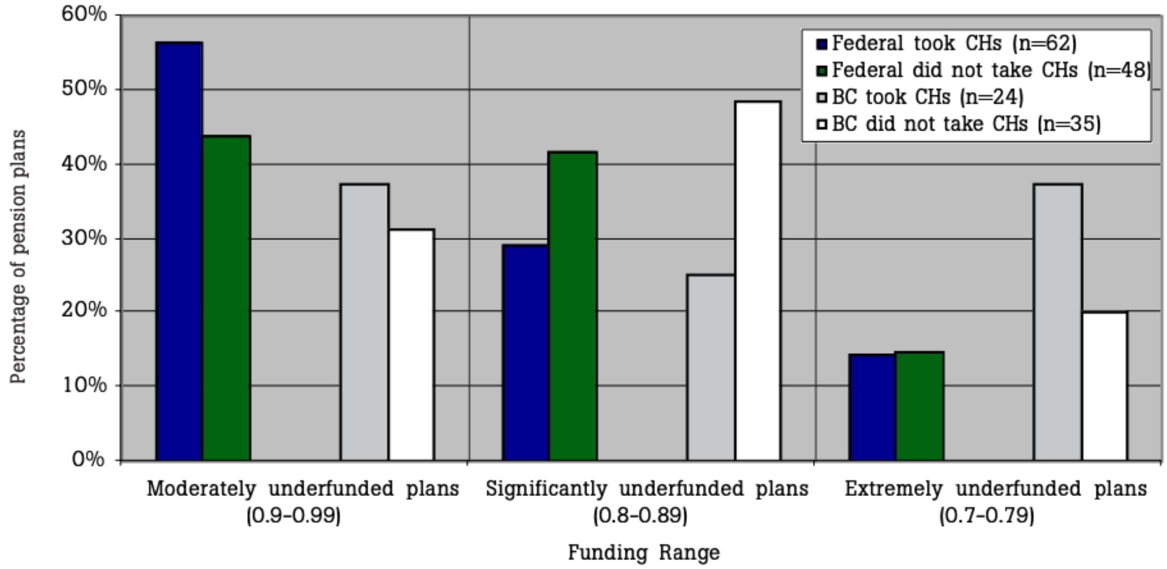
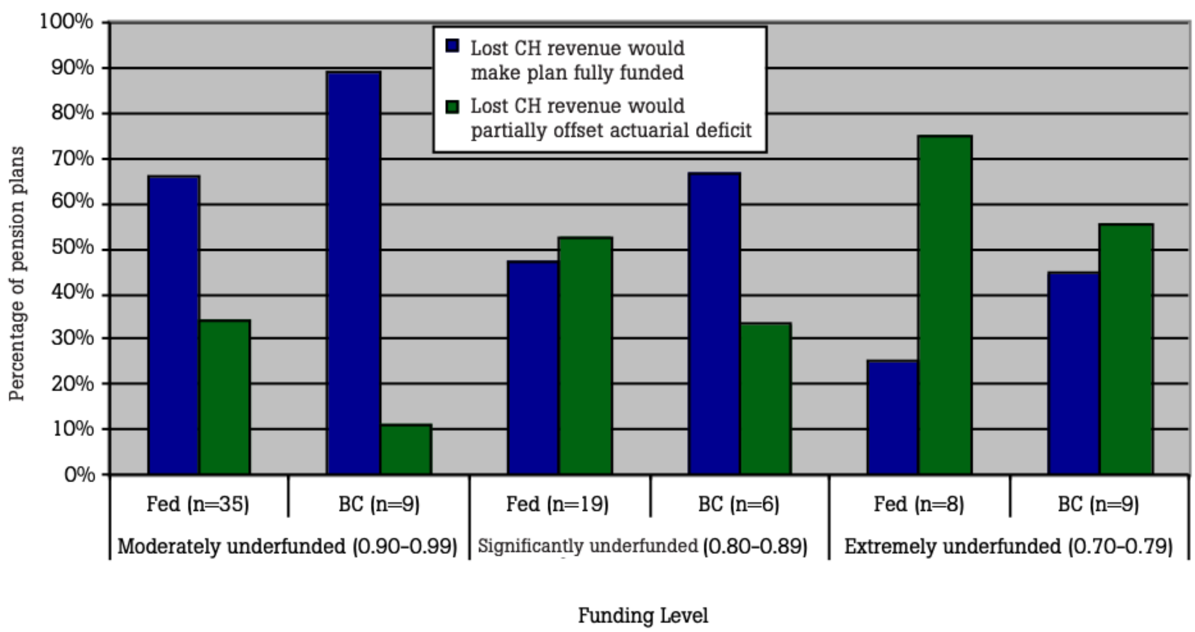


Chart 6: Effect of Lost Revenues from Contribution Holidays Taken Between 1994 and 2003 on Current Actuarial Deficit



These findings highlight the disconnect between current funding policy that encourages short-term decisions respecting employer contributions based on triennial valuations and the need for a long-term orientation toward plan funding that takes into consideration long-term variations in markets, interest rates and plan demographics.

Table 1: Extremely Underfunded Active B.C. Defined Benefit Pension Plans

Pension plan	Plan sponsor	Most recent actuarial valuation	Funding ratio (%)	No. of CH	Actuarial deficit ($)	Lost revenue from CH ($)	Lost revenue as % of deficit
Gorman Bros. Lumber Ltd. Pension Plan for Salaried Employees	Gorman Bros. Lumber Ltd.	31/12/2002	79.91	6	1,212,000	993,017	81.93
Pension Plan for Employees of Central Heat Distribution Limited and Subsidiaries	Central Heat Distribution Limited	31/12/2002	79.61	8	371,400	411,895	110.90
Brewers' Distributor Ltd. Pension Plan for Bottle Sort Employees in British Columbia	Brewers' Distributor Ltd.	31/12/2002	79.50	1	1,289,033	33,496	2.60
B.C. Lottery Corporation Pension Plan	B.C. Lottery Corporation	31/03/2003	79.02	2	9,434,799	441,223	4.68
Brewers' Distributor Ltd. Pension Plan for Hourly Employees in British Columbia	Brewers' Distributor Ltd.	31/12/2000	77.48	1	4,989,607	169,569	3.40
Northern Hardware & Furniture Co. Ltd. Employees' Pension Plan	Northern Hardware & Furniture Co. Ltd.	31/12/2002	76.35	4	390,300	112,663	28.87
Calona Wines Limited Trusteed Retirement Plan	Calona Wines Limited	31/12/2002	76.24	4	1,651,500	746,107	45.18
Pope & Talbot Ltd. Retirement Plan for Employees Represented by the Canadian Merchant Service Guild	Pope & Talbot Ltd.	31/12/2002	67.07	3	2,051,600	329,814	16.08
Norske Skog Canada Limited Retirement Plan A	Norske Skog Canada Ltd.	31/12/2001	21.99	5	15,250,154	37,603	0.25

Table 2: Extremely Underfunded Active Federal Pension Plans

Pension plan	Plan sponsor	Most recent actuarial valuation	Funding ratio (%)	No. of CH	Actuarial deficit ($)	Lost revenue from CH ($)	Lost revenue as % of deficit
Pension Plan for CAW Members Employed by Canadian Airlines International Ltd.	Air Canada	01/01/2003	0.79	3	338,399,000	60,322,634	17.83
United Air Lines, Inc. Vancouver Agent Employees' Retirement Plan	United Air Lines, Inc.	01/01/2003	0.77	1	6,593,706	29,447	0.45
Pension Plan for Employees of Symcor Inc.	Symcor Inc.	01/01/2003	0.76	3	130,988,000	30,192,195	23.05
Employees of Hudson Bay Mining and Smelting Co., Limited	Hudson Bay Mining & Smelting Co. Ltd	31/12/2002	0.75	2	66,937,000	3,707,538	5.54
Régime de retraite des salaries de TQS inc.	TQS inc.	31/12/2002	0.73	2	3,650,400	991,289	27.16
Newfoundland Telephone Company Limited Employees Pension Plan	Aliant Inc.	31/12/2002	0.71	4	407,057,000	68,868,200	16.92
Prince Rupert Grain Ltd. Employees' Retirement Plan	Prince Rupert Grain Ltd.	01/01/2001	0.71	1	2,901,700	3,463	0.12

Discussion and Recommendations

PENSION FUNDING POLICY CONSISTENTLY STRUGGLES TO ACHIEVE THE APPROPRIATE balance between providing guidance and flexibility. Minimum funding standards serve to ensure that plan sponsors can meet their promise to plan members and beneficiaries in light of constantly changing market dynamics and changes in the corporate environment, such as workforce reductions and corporate reorganizations. However, flexibility is also necessary to allow plan sponsors and workers to utilize pension assets and surplus in the best interests of plan members and beneficiaries. Many of the benefit improvements secured by unions on behalf of workers in the 1990s were due to existing flexibility in funding policy. This section raises a number of issues emanating from the study's findings related to funding policy and practice. Further discussion and research on each matter is recommended to achieve a better balance than presently exists. Five specific recommendations are also presented regarding disclosure and transparency of plan information.

Plan Surplus Limits Under the Income Tax Act

All sectors of the pension industry have called for an increase in or the elimination of plan surplus limits under the *Income Tax Act*. Clearly, the current caps on funding levels ignore the need for an adequate buffer to deal with long-term fluctuations in capital markets and investment returns.

In its recommendations, the CGAA suggests that

> The Department of Finance Canada should revisit the 10 per cent cap (disallowance of surplus amounts which exceed liabilities by 10 per cent or more) historically placed on DB balance sheet surpluses in favour of elevating the limit, to say 30 per cent, or discarding the provision altogether. Retrospectively and prospectively, we can expect that the 10 per cent rule does in some instances force a sponsor to take contribution holidays when the sponsor may not otherwise do so.[48]

Keith Ambachtsheer concurs with this position in his report for the C.D. Howe Institute: "The relatively low 10 per cent cap that the federal government has historically placed on DB balance sheet surpluses has impeded the proper management of balance sheet risk. The 10 per cent limit is now under review, and should be reset at a much higher level – such as 30 per cent – if it is retained at all."[49]

In its White Paper, Towers Perrin recommends "increas[ing] the amount of surplus that may be held in a plan prior to requiring contribution holidays."[50] It observes that "DB plans would no doubt be in better funding positions today had their sponsors been able to contribute more during stronger parts of the business cycle. With this in mind, it would also be advisable for the *Income Tax Act* to provide greater flexibility for employers who wish to build a security margin into their pension funds. These companies should be able to continue making contributions even if the plan is already in a surplus position."[51]

According to Bob Baldwin, Director of Social and Economic Policy for the Canadian Labour Congress, the arguments about funding are directly linked to the current push toward conversion of defined benefit plans to defined contribution plans. "If no solution is found to the excessive sensitivity of current arrangements to short-term changes in financial markets, we may see more plan windups and/or conversions of defined benefit plans to defined contribution plans."[52] These comments draw the connection between short-term pension funding policy, such as provisions dealing with contribution holidays, and the resulting pressure to convert defined benefit plans when markets and economic variables are not favourable.

Others within the labour movement have queried whether there are other means of utilizing plan surplus in a way that benefits both employers and plan members, such as dedicated application of excess funds in a manner that directly creates jobs and improves job security, wages and other benefits.

Unfortunately, Canadian regulators do not track the reasons for employers withholding contributions. Accordingly, it is not possible to know the proportion of contribution holidays taken as a direct result of the *ITA* limit or voluntarily for other reasons. For example, some companies may follow a practice of over contributing during profitable years and under contributing in years when they do not have taxable profits. Nevertheless, this study's findings do suggest that increasing or eliminating the surplus cap would likely reduce the frequency of employer contribution holidays and support more long-term prudent funding decisions. In making this observation, it is recognized that governments receive significant tax revenues from withheld contributions. According to OSFI, contributions withheld by federally registered pension plans between 1994 and 2003 totaled $3.6 trillion. Any approach will therefore have to balance the interests and objectives of government, plan sponsors, and plan members and beneficiaries in this regard.

Prohibition on the Application of Surplus to Cover Current Service Costs

In the same vein, labour representatives on the other side of the Atlantic have recommended prohibiting the use of surplus to pay for current service costs. The Trades Union Congress – the umbrella organization for the UK labour movement – recently called on the British government to prohibit contribution holidays.[53] Such a recommendation faces a number of challenges in Canada. First, there is the continued uncertainty about surplus ownership and constraints on how surplus may be utilized. Second, absent strict funding rules, there will be the temptation to "high-ball" earnings assumptions in the future (when interest rates inevitably increase) to reduce servicing costs.

One approach would be to hold surplus funds in a segregated trust for use by the pension plan to offset actuarial or real deficits reported in future years. In the event of a plan wind up or corporate insolvency context, these contributions could be applied to pay down the real deficit. From the employer's perspective, this would avoid the need for large supplementary contributions that place a drain on company revenues. For employees, it would provide assurance that the pension promise will be fulfilled. Alternatively, consideration might be given to prohibiting contribution holidays when a plan's funding ratio has experienced a prescribed degree of volatility over the past decade.

Mandatory Long-term Asset/Liability Matching Studies

The practice of contribution holidays highlights the conflicting imperatives faced by Canadian pension plans. On the one hand, pension plans must take a long-term view with respect to plan funding and investments. The OECD Secretariat has reiterated the accepted view that "pension investments are – by definition – long term both in terms of the long accumulation period and the long period during which benefits are drawn. Therefore investment decisions and pension benefit expectations should be based on long-term performance forecasts."[54] On the other hand, current pension regulation and market dynamics encourage a short-term orientation. Pension plans are required to conduct triennial actuarial valuations, which in part determine the level of contributions required during the subsequent three years. This promotes a short-term orientation to structuring plan funding and encourages employers to take contribution holidays when the plan has an actuarial surplus without regard for longer-term events, such as market downturns. With 56 per cent of the average Canadian pension plan's portfolio invested in equities, the long-term effect of market fluctuations can have a significant impact on plan funding, as many plans experienced between 2000 and 2002. One means of reorienting plan sponsors and administrators towards a long-term perspective is by requiring plans to conduct asset/liability matching studies that demonstrate various scenarios and consequently allow for long-term planning.

These three issues – plan surplus limits, contribution holiday prohibitions, and mandatory long-term asset/liability matching studies – are all dependent to some extent on the underlying debate over the ownership and management of plan surplus. The study's results also suggest the need for greater oversight of actuarial practices and protections for individuals who report on material contraventions of pension legislation.[55] Unfortunately, a detailed investigation of these issues is beyond the scope of this study. They are highlighted here because of their direct relationship to the findings of this study that indicate that contribution holidays taken by employers during the past decade exacerbated the current funding shortfalls of many pension plans.

The experience of conducting this study also revealed problems with existing practices in the collection, management, disclosure and transparency of information regarding plan funding. The growing public concern of Canadians over the health of our national retirement security system requires greater disclosure and transparency so that Canadians can better understand and evaluate the condition of Canadian pension plans. Accordingly, the following five recommendations are provided to improve disclosure and transparency in the public interest.

RECOMMENDATION 1: CAPSA members should establish a uniform reporting mechanism for all registered pension plans to ensure that data received by regulators is meaningful and comparable.

The experience of collecting data for this study illustrates that Canadian pension regulators do not have a uniform manner of collecting pension data from registered pension plans making comparative analysis difficult. It is therefore recommended that Canadian pension regulators under the auspices of CAPSA agree upon and develop a uniform reporting mechanism for all registered pension plans in Canada to enhance the quality and comparability of pension data.

RECOMMENDATION 2: CAPSA should develop a uniform data management system to allow all jurisdictions to properly track and report on plan data.

The experience of requesting pension data from pension regulators revealed significant differences in how regulators collect and manage pension data. Regulators use different technology and software, and organize information in a variety of ways. A number of jurisdictions lack any framework for data management. Therefore, it is recommended that Canadian pension regulators under the auspices of CAPSA develop a uniform data management system that allows for the tracking, management and reporting of plan data. Such a system does not need to violate privacy rules, but simply ensure that each regulator is using the same framework for tracking pension information.

RECOMMENDATION 3: As a matter of public interest, governments, in consultation with CAPSA, should make accessible to the public aggregate data of a non-personal nature collected from pension plans.

The funding status of pension plans in Canada is a matter of public interest. With more and more workers entering retirement, the status of Canadian pension plans is becoming an increasingly serious issue. Many retirees and their dependents are now finding themselves with inadequate resources to meet their retirement needs, which directly impacts their health and potentially their safety. Similarly, the large number of underfunded pension plans in Canada has called into serious question the stability of retirement security for all Canadians, a matter that directly impacts on the long-term health and well-being of those who currently contribute to or receive the benefits of a pension.

Currently, pension legislation and freedom of information legislation in all jurisdictions places limits on what pension plan information may be disclosed and who may obtain it. The specific limits vary according to jurisdiction and interpretation of these limits is highly subjective.

Responses received from the regulators demonstrate the lack of consensus regarding the treatment of non-personal pension funding information, including information from the plan's actuarial valuation sought for this study. Currently, some regulators consider non-personal pension information to be public domain while others view it as confidential information between the plan sponsor and plan members. This difference in perception means that the general public is afforded access to information regarding some pension plans and not others. In certain instances, treatment of non-personal pension information is left to the discretion of the regulator, while some provincial legislation mandates confidential treatment of such information.

As a matter of public interest, it is recommended that existing rules be amended to permit disclosure to the general public of pension information that is of a non-personal nature and that does not infringe on the privacy of individual plan members or beneficiaries.

RECOMMENDATION 4: Regulations governing the treatment of data collected by Statistics Canada with respect to retirement security should be amended to allow access to non-personal data for research purposes conducted in the public interest.

Statistics Canada's enabling legislation prohibits disclosure of discrete data received from respondents under most circumstances.[56] For reasons of public interest detailed above, it is recommended that the legislation governing Statistics Canada be amended to allow for access to non-aggregated data on a "no-names" basis, for research purposes only, that does not reveal the identity or infringe on the privacy of a plan sponsor or individual. Any policy in this regard must realize a balance between maintaining the confidentiality of companies (so that they continue to provide data to Statistics Canada) and the need for public access to data for public interest research purposes.

RECOMMENDATION 5: All plan sponsors and plan administrators should be required to disclose their funding requirements, funding surplus/deficit, and time of future payments in their financial statements.

This recommendation flows from the findings of the Dominion Bond Rating Agency report looking at the health of Canadian pension plans.[57] The report notes that Canadian companies are not required to disclose their funding requirements and timing of future payments in their financial statements. Furthermore, current accounting rules permit pension liabilities to be excluded from a company's balance sheet.[58] Consequently, "it is very difficult to estimate future funding requirements with publicly disclosed information. Disclosing funding requirements would be very useful in assessing the impact of required company contributions on future cash flows."

Pension data with respect to some of the most severely underfunded pension plans was not available because the respective plan sponsors are not publicly traded companies and therefore are not required to disclose information publicly. In such instances, governments should require disclosure of the above information as part of the company's annual corporate or pension filings to provide comparable public disclosure to that required of publicly traded companies.

Conclusions

THE STUDY'S RESULTS DEMONSTRATE THAT THE ACCEPTED PRACTICE OF EMPLOYERS withholding contributions can have a significant impact on the health of Canadian pension plans. The majority of pension plans with current actuarial deficits withheld contributions in one or more years between 1994 and 2003. In many instances, the lost principal and interest from these contribution holidays would have significantly reduced the actuarial deficits of a large portion of pension plans.

The incomplete or unavailable information for this study makes it impossible to draw definitive conclusions about other Canadian jurisdictions, but available data does indicate that other jurisdiction have similar percentages of underfunded pension plans.[59] It is likely that these plans show similar patterns of lost revenues from employer contribution holidays.

While recognizing that there is no quick fix to existing pension funding concerns, the findings and recommendations emanating from this study evidence the need for further study in this area and a review of funding rules and regulations, particularly as they relate to contribution holidays. Efforts in this regard would be supported by improvements to pension data reporting and management, and improved access to pension funding information.

Notes

[1] Certified General Accountants Association of Canada, *Addressing the Pensions Dilemma in Canada* (2004) available at http://www.cga-online.org/servlet/portal/serve/Library/Advocacy+and+Research/CGA-Canada+Key+Areas+of+Interest/Pensions/ca_pensions_report.pdf.

[2] Jim Armstrong, "What Is the Funding Status of Corporate Defined Benefit Pension Plans in Canada?" in *Financial System Review* (Ottawa: Bank of Canada, 2004) at p. 49 available at http://www.bankofcanada.ca/en/fsr/2004/report_0604.pdf.

[3] Keith Ambachtsheer, *Cleaning Up the Pensions Mess: Why it will take more than money* (C.D. Howe Institute, February 2004) available at http://www.cdhowe.org/pdf/backgrounder_78.pdf.

[4] Linda Scott & Walter J. Schroeder, *Not As Bad As They Look* (Dominion Bond Rating Service Limited, July 2003) available at http://www.dbrs.com/web/sentry?COMP=2900&DocId=125740.

[5] OSFI 2003-2004 Annual Report at p. 25 available at http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/reports/osfi/osfi2004_e.pdf.

[6] *Ibid.* at p. 18. *See also* CGAA, *supra* note 1 at pp. 11, 13: "[gains] were offset by a fall in long-term interest rates of about 40 basis points which accounted for an increase in plan liabilities of approximately 5% to 10%."

[7] Scott & Schroeder, *supra* note 4 at pp. 30-31.

[8] CGAA, *supra* note 1 at p. 14.

[9] *Supra* note 2.

[10] Towers Perrin, *Renovate to Rejuvenate: Canadians Need a 21st Century Pension Plan* (May 2004) available at http://www.pensiontalk.com/pdf/White_Paper-Towers_Perrin.pdf.

[11] "Time to end a scandal" (October 28, 2004) *The Economist*.

[12] "Murk in the gloom" (October 28, 2004) *The Economist*.

[13] Mihir Desai, Daniel Bergstresser, Joshua Rauh, *Earnings Manipulation, Pension Assumptions, and Managerial Investment Decisions* (Unpublished October 2004) available at www.ssrn.com.

[14] Towers Perrin, *supra* note 11 at p. 6. Some contend that the historical mismatch between plan investments and liabilities accounts for some of the extreme funding scenarios currently faced by some plans. However, greater exposure to long bonds would have obliged actuaries to cut the discount rate, making plans more expensive for plan sponsors who would have been required to increase contribution requirements and liabilities, which in turn could have reduced the level of plan improvements made in the last two decades of the 21st century.

[15] *See also* National Bank Financial study cited in Caroline Cakebread, "Understanding liabilities" (August 2002) *Benefits Canada* 11. The flexibility of earnings assumptions is more of an issue in the context of going-concern valuations. Solvency valuations are subject to much narrower parameters. Between 1985 and 2000, the focus was primarily on going-concern valuations rather than solvency valuations. With the drop in long-term rates below even the most conservative going-concern assumptions, attention is now given mostly to solvency valuations.

[16] Armstrong, *supra* note 2 at p. 45.

[17] Statistics Canada, "Employer pension plans" (August 5, 2004) *The Daily* available at www.statcan.ca/Daily/English/040805/d040805a.htm. The practice is not limited to Canada. *See* discussion of UK situation in ICFTU Worker Capital News, "Companies 'architects of their own misfortune…'" (March 6, 2003).

[18] OSFI states in its 2003-2004 Annual Report, *supra* note 6, that 16 pension plans were contacted that might warrant an early valuation report to anticipate whether increased funding is required.

[19] CGAA, *supra* note 1 at p. 35.

[20] Armstrong, *supra* note 2 at p. 51.

[21] *See e.g. The National,* "How safe is your pension" (Nov. 15, 2004) discussing the bankruptcy of Cold Metal Products Ltd. text available at *www.cbc.ca*; CGAA, *supra* note 1 at p. 16 discussing the case of Jeffrey Mines in Quebec. Recently, the Ontario court mandated United Airlines to continue making contributions to its pension plan while the company is under CCAA protection and undergoing restructuring.

[22] Janet McFarland, "Pensions threaten future profits, directors fear" (November 15, 2004) *Globe & Mail* p. B3.

[23] Pension plans are required by regulation to conduct valuations on both a going-concern and solvency basis.

[24] Alternatively, where going-concern payments are insufficient to address solvency deficiencies, additional contributions must be made. Legislation requires that funding deficiencies based on a going-concern valuation must be funded over 15 years, while solvency deficiencies must be funded over a maximum of five years.

[25] CGAA, *supra* note 1 at p. 67.

[26] *Schmidt v. Air Products Canada Ltd.,* [1994] 2 S.C.R. 611 at p.3 (QL). And at p. 25, "…the trust property usually consists of all the monies contributed to the pension fund. To permit a contribution holiday does not reduce the corpus of the fund nor does it amount to applying the monies contained in it to something other than the exclusive benefit of the employees. The entitlement of the trust beneficiaries is not affected by a contribution holiday. That entitlement is to receive the defined benefits provided in the pension plan from the trust and, depending upon the terms of the trust to receive a share of any surplus remaining upon termination of the plan."

[27] See e.g. *C.U.P.E – C.L.C., Local 1000 v. Ontario Hydro* (1989), 68 O.R. (2d) 620.

[28] *Schmidt v. Air Products Canada Ltd.*, *supra* note 27.

[29] *Chauteauneuf v. TSCO of Canada Ltd.* (1993), 1 C.C.P.B. 52 (Que. S.C.), aff'd (1995), 124 D.L.R. (4th) 308 (Que. C.A.), leave to appeal to S.C.C. denied (1995), 124 D.L.R. (4th) vi.

[30] *Pension Benefits Standards Regulation*, s.9(9).

[31] *Ontario Pension Benefits Regulation*, SOR/2001-222, s.7(3), 9.

[32] Alta. Reg. 364/86, s.34(9).

[33] *Pension Benefits Standards Regulation*, BC. Reg. 433/93, s.36.

[34] Newfoundland, the only other jurisdiction with a prescribed threshold, sets it at 10 per cent of plan liabilities (*Newfoundland and Labrador Regulation* 114/96, s.21).

[35] Funding ratios for provincial plans were not reviewed in each year that contribution holidays were taken to determine compliance with rules governing the withholding of contributions. Nevertheless, the study's general findings suggest the likelihood that a number of pension plans that took contribution holidays were in contravention of provincial regulations at the time.

[36] *Income Tax Act,* R.S.C. 1985, c.1 (5th Supp.), 147.2(2)(d).

[37] *Aegon Canada Inc. and Transamerica Life Canada v. ING Canada Inc.,* [2003] O.J. No. 448 (S.C.J.) at 12 (QL).

[38] Hybrid pension plans were not included in the study sample because of complexities in calculating the impact of contribution holidays on overall funding.

[39] Information was not obtained to compare the actuarial value of plan assets against market value. Greater reliability may be placed on funded ratios where the actuarial value of plan assets is less than the market value. Conversely, funded ratios based on actuarial values that exceed market value should be of concern. Future study on this topic could explore this to better assess the reliability of funded ratios.

[40] Pension plans are required to submit actuarial valuations to the regulator at least once every three years and within one year after an actuarial deficit is reported.

[41] Not all pension regulators produce publicly available annual reports on the status of registered pension plans in their jurisdiction.

[42] Manitoba's data begins in 1997.

[43] The solvency of a pension plan is determined by an actuarial valuation that must be completed at least once every three years. There are two common approaches to valuing a pension plan. The *solvency ratio* – calculated by dividing the plan's assets by its liabilities using actuarial values – measures the ability of a plan to meet its obligations assuming that the plan is wound up as of the calculation date. Valuation on a *going-concern basis* is calculated in the same manner and assesses the ability of the plan to meet its liabilities assuming the plan were to continue into the future.

[44] *See e.g.* CGAA, *supra* note 1.

[45] As reported by Mercers Investment Consulting in its *Summary of Investment Performance Survey of Canadian Institutional Pooled Funds* available at www.mercerIC.com.

[46] This study did not consider how many underfunded plans that took contribution holidays also made plan improvements during the study period. Further research on this issue might consider deducting the cost of such improvements from a plan's unfunded liabilities.

[47] It is not appropriate to include moderately underfunded pension plans in this observation because small funding deficits observed in the study are generally manageable from a funding perspective or otherwise easily accounted for through slight variations in actuarial assumptions.

[48] CGAA, *supra* note 1 at p. 70.

[49] Ambachtsheer, *supra* note 3 at pp. 9-10.

[50] Towers Perrin, *supra* note 11 at p. 11.

[51] *Ibid.* at p. 7.

[52] Bob Baldwin, Pension Reform in Canada in the 1990s: What Was Accomplished, What Lies Ahead? (Ottawa: Canadian Labour Congress, April 2004) at pp. 25-26.

[53] Daniel Brooksbank, "UK unions want compulsory employer contributions" (September 13, 2004) *IPE.com*.

[54] OECD Secretariat, "Funding Rules and Implications for Pension Fund Investment" available at www.inprs.org.

[55] Section 40 of CAPSA's *Proposed Regulatory Principles for a Model Pension Law* (January 2004) provides limited "whistleblower" protection against civil liability. The Canadian Institute of Actuaries has stated that it will not act as whistleblower; however, it has recommended peer review of actuarial valuations, which represents a first step towards greater transparency and accountability. Charges were recently laid by the Financial Services Commission of Ontario against Aon Consulting Inc. and one of its actuaries alleging the parties breached their fiduciary duties by overstating the value of pension assets at Slater Stainless Corp. in 2002 prior to the company declaring bankruptcy in 2003. The claim alleges that the defendant actuary misstated the value of plan assets in two company plans by over 40 per cent of market value, resulting in a solvency funding excess rather than a solvency deficiency, and consequently relieving the employer from the obligation to make contributions to the plan in that year. *See* James Daw, "Pension watchdog charges actuary, firm with overstating assets" (April 27, 2005) *Toronto Star*.

[56] *Statistics Act,* R.S.C. 1985, c.S-19, s.18.

[57] Scott & Schroeder, *supra* note 4.

[58] Christine Wiedman, Heather Wier and Andre Zybul, "Whither the pension plan? Accounting rules mask increasing debt" (January/February 2003) *Ivey Business Journal* 1.

[59] Saskatchewan reports that for plans filing valuations at year end in 2001 and 2002, 38.6 per cent (56) representing 6.5 per cent of all beneficiaries did not meet the requisite funded ratio (>1.00) with a total of $54 million in unfunded liabilities on a going-concern basis. *See* Pensions Division, *A Statistical Perspective On Pension Plans Registered In Saskatchewan* (Financial Services Commission, Saskatchewan: 2002).