Intelligence MEMOS

From: Joe Nunes

To: Ontario Defined-benefit Pension Holders

Date: January 25, 2021

Re: Replacing Ontario's Pension Benefits Guarantee Fund

Ontario's Pension Benefits Guarantee Fund (PBGF) is up for review before May 2021.

The PBGF is designed to provide protection to Ontario members of most defined-benefit pension plans when a plan is wound-up and there are insufficient assets to pay all promised pensions and there is no solvent employer to provide the needed additional contributions. In principle this is meant to protect retirees not well positioned to protect themselves when a pension plan fails.

Unfortunately, the PBGF doesn't work very well. Benefit protection is capped at $1,500 per month, which does not cover promised pensions in many cases. Premiums charged to plan sponsors do not reflect the likelihood that they will need the protection and historically, total premiums collected have been grossly insufficient to cover the benefits paid, which means the government has had to extend loans and grants to the program.

Where do we go next?

We hear three common suggestions for improvement:

1. Operate the PBGF like a proper insurance program – charging premiums not only based upon the size of a plan's unfunded liabilities but also on the plan sponsor's credit worthiness;
2. Change the federal *Bankruptcy & Insolvency Act* to give pension plan members and retirees higher priority when a business fails; and
3. Introduce tougher funding rules so the risk of underfunding pensions is dramatically reduced.

Wrong answers

I am not convinced that Queen's Park could manage a properly run insurance program, and even if possible, I don't like the idea of the public sector taking a role in which private sector insurers and lenders are already experts.

In terms of bankruptcy act amendments, it is never clear how high up the priority list proponents of this approach want to move pension plan members – but surely the sentiment is that it should be ahead of secured creditors that have loaned the plan sponsor money. The problem with this proposal is that lenders have made lending decisions based upon the current rules and there is an unfairness to changing the rules after the money has been loaned. In addition, such a change would mean that some plan sponsors will become unable to borrow new funds, which might drive the insolvency and pension reductions that we are all trying to head off.

Finally, government has realized in recent years that onerous funding rules for defined-benefit plans has put undue strain on the companies sponsoring them and has driven many sponsors to discontinue offering a guaranteed pension to workers. As a result, Ontario, and other governments have moved in the direction of softening pension funding rules – not toughening them.

Better approaches

The best answer would see the Ontario government exiting the pension guarantee business which no other province offers. Most private sector workers lucky enough to have a pension plan are now in defined-contribution plans for which there are no government guarantees, and it adds insult to injury to ask these workers to subsidize an underfunded PBGF through taxes. The best approach would be to ensure defined-benefit pension plan members better understood that they are relying on their employer to deliver whatever guarantee hasn't been pre-funded by the pension fund assets accumulated to date.

However, it may be difficult for politicians to abandon the guarantee program, so here is a more palatable approach for the legislature:

- Require plan sponsors to hold letters of credit in the amount of some or all the pension fund deficit. This would properly price the insurance coverage for each employer and create incentives for sponsors to better fund the pension plan in order to reduce the cost of the letters of credit. Of course, this would only apply to a province that enacted such legislation and would undoubtedly continue the uneven pension protection provided to plan members across Canada.

- Increase the priority of pension plan members in insolvency – but make the change effective 10 or 20 years hence, thus allowing almost all current lenders to get their loans out and renew on terms that better reflect the revised risk for lenders that the new rules create. This would provide a better system of protection for pension plan members across Canada.

These two ideas would maintain pension guarantees, but would transfer the cost to each employer equitably. While it might be uncomfortable for the government to admit defeat on the PBGF, it would be a one-time reputational hit as compared to the explosion of complaints that occurs every time we rediscover that pensions really aren't fully guaranteed, as well as the accompanying taxpayer criticism every time the Minister of Finance has to cover PBGF shortfalls.

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