STRENGTH IN NUMBERS

Multi-employer pension plans can provide a defined benefit pension plan…with a defined contribution approach to funding.

By Mark Davis, Susan Deller and Cameron Hunter

So far, Canadian regulators' efforts to stem the tide of declining defined benefit (DB) plans have focused on reducing the impact of solvency funding requirements. But there's another option. It's been around for decades and already provides pension benefits to over a million Canadians. It's the multi-employer pension plan (MEP).

Late last year, Bank of Canada Governor David Dodge called on policymakers to establish proper incentives to encourage plan sponsors to maintain their DB pension plans. He argued that Canada's pension plan system is crucial to our future, not only because it provides retirement income to our seniors, "but also because it supports the efficiency of our financial markets and our overall economy in important ways."

For him, the decline of DB plans must be reversed for two key reasons. First, the growing popularity of defined contribution (DC) plans represents a transfer of "return risk" and "longevity risk" to individuals, who are less able to bear or manage them. Second, this transfer of risk "has a negative impact on overall economic efficiency and could ultimately represent a significant threat to the ability of pension funds to finance the long-term investments that will maximize our economy's future potential growth."

Dodge outlined several steps that policymakers could take to "rebalance the incentives for sponsors to operate defined benefit plans." Central among these was to encourage the creation of plans sponsored by multiple employer/employee groups to provide a pooling mechanism for members against bankruptcy and other risks. He was, in fact, advocating the MEP model as a possible key to preserving DB pensions in Canada—with good reason.

THE BENEFITS OF POOLING

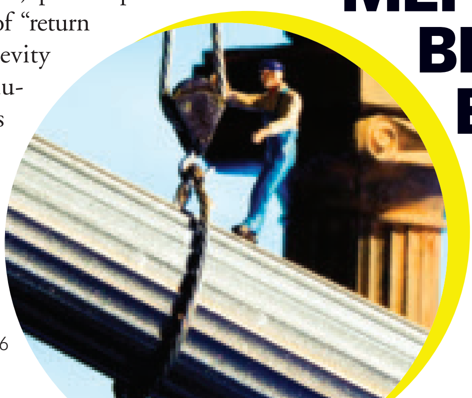
For employers, the funding obligation in a MEP is limited to a fixed schedule of contributions (Quebec excepted), with administration costs shared across the entire group. For members, MEPs provide a predictable, targeted benefit at retirement without the individual return and longevity risks associated with DC plans. This pooling means that members can generally expect to receive greater benefits than they would if they were participating in an equivalent cost DC plan.

This isn't to say that MEPs aren't without their challenges. Like single-employer DB plans, most MEPs in Canada are grappling with solvency deficiencies and many MEPs have been forced to reduce benefits or curtail benefit accruals. In fact, the ability to reduce benefits, both future service benefits and, in many jurisdictions, benefits already earned, is one of the defining features of MEPs. Some may see this as a fatal flaw. But, because they typically have shared governance with representation from employers and members, and have generally adopted actuarial assumptions that are more conservative than typical single employer plans, MEPs that are well-managed and well-communicated have, for the most part, been able to deal with these issues very effectively.

THE MAKINGS OF A MEP

For most corporate plan sponsors, and even many pension professionals, MEPs remain something of a mystery. They are often mistaken as union-only plans or are believed to be the exclusive realm of the construction trades. Few understand how MEPs work.

In broad terms, a MEP is a registered pension plan with two or more participating employers. If a MEP qualifies as a Specified MEP (SMEP), it has the advantage of being permitted to report pension adjustments



MEPS PROVIDE A DB-TYPE BENEFIT, BUT FREE EMPLOYERS FROM THE RISK OF PAST SERVICE UNFUNDED LIABILITIES.

(PAs) using the simpler—and generally less punitive—rules that apply to DC plans. So, the member's PA is simply equal to the total contributions made in the year by the employer and the member. There are also no past service pension adjustments, pension adjustment reversals, or maximum pension rules to worry about.

To qualify as a SMEP, the MEP must be administered by a board of trustees or similar body that is not controlled by participating employers. It must also satisfy additional conditions related to:

- the number of unrelated participating employers;
- the tax status of those employers (at least 90% not tax-exempt); and
- the nature of employer contributions (made pursuant to collective bargaining or similar agreement and not variable according to the plan's financial experience).

A plan may also be designated as a SMEP by the Minister of National Revenue if it satisfies most of the above conditions and would have serious difficulties reporting PAs if it were not designated as a SMEP

In theory, there is no reason why any group of employers couldn't collaborate to establish a new MEP. Currently, most MEPs are structured for employers within a common industry or drawing from the same workforce. Also, because contributions tend to be negotiated and the benefits related to those contributions are often applied uniformly to all participating employer workforces, individual employers may have less flexibility in providing benefits that are differentiated among member groups.

However, MEPs do exist that cover widely disparate employee groups with very different benefits within one plan (see "Portrait of a SMEP").

ACCORDING TO STATISTICS CANADA, THERE ARE OVER 500 MULTI-EMPLOYER PLANS OPERATING IN CANADA COVERING OVER ONE MILLION ACTIVE AND RETIRED PLAN MEMBERS.

Portrait of a SMEP: The Canada-Wide Industrial Pension Plan

The Canada-Wide Industrial Pension Plan was established in 1970 and is open to any employer who has a collective bargaining agreement with a union that is affiliated with the Canadian Labour Congress (CLC). The plan currently has over 25,000 members, 130 participating employers and $200 million in assets. Administration is centralized and the related cost is spread among all participating groups

The plan is a target defined benefit pension plan. This means that the retirement benefit level for each employee group is based on a pre-set formula, but is not guaranteed by the employer, union or government. In other words, if there is a shortfall in the assets available for providing pensions, the retirement benefit level could be adjusted.

To participate, an employer and employee group must first agree on a contribution rate which will, in turn, decide the target retirement benefit level. All contributions are paid by the participating employer. Contribution rates vary by group based on each group's demographics; targeted retirement benefit level; and plan features (they may, for instance, agree to enhance the basic plan with additional features, such as unreduced early retirement, bridge benefits or survivor benefits).

The Canada-Wide Industrial Pension Plan is governed by an independent board of trustees made up of an equal number of employer and CLC-appointed representatives. The board is responsible for overall governance of the plan, including approving plan changes, establishing investment policy, monitoring investment performance and monitoring the long-term financial health of the plan. Like all fiduciaries, the trustees have a legal obligation to act in the best interest of plan members. This obligation takes precedence over allegiances to other parties or interests—including the organizations that have appointed them.

QUEBEC'S PROPOSED MEMBER FUNDED PENSION PLAN (MFPP), WHICH IS INTENDED TO ELIMINATE THE EMPLOYER'S FUNDING RISK, SHARES SOME OF THE ELEMENTS OF A MEP. HOWEVER, IT PLACES LIMITS ON EMPLOYER FLEXIBILITY AND INCLUDES BENEFIT RESTRICTIONS THAT COULD MAKE IT UNATTRACTIVE FOR MANY EMPLOYERS.

On the other hand, in competitive industries where the fight for human capital will intensify as baby boomers continue to age and labour shortages grow, the prospect of establishing a MEP and, in effect, removing pension benefits from the attraction/retention equation could be attractive to employers who prefer to focus on other differentiating factors.

Will we see a new wave of MEPs in the coming months and years? Considering the positive—even crucial—role that DB plans can play in Canada's future, the large number of employers who see great merit in DB plans but who find it increasingly difficult to build a business case for them in the current legislative environment, and employees' persistent desire for benefit predictability, there's little doubt that MEPs present an appealing alternative. How large a swath they cut in Canada's future pension landscape may depend largely on the willingness of employer/employee groups to collaborate for a common goal. **BC**

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