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Union Dos

How to transform pensions in today’s collective bargaining environment

By Karen Tarbox and John McIntosh

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The combination of low interest rates, market volatility, maturing plans and accounting reforms have caused many plan sponsors—as well as the shareholders or taxpayers to which they are accountable—to look at the affordability and sustainability of their retirement benefit programs. The traditional indexed DB plan, long the hallmark of unionized workforces, is being reconfigured into new forms of retirement savings.

Private Sector Trends
For non-bargained pension programs, the most common plan design path over the last decade or so has been a “soft freeze” of the DB provision combined with the adoption of capital accumulation plans (CAPs)—typically DC pension plans or group RRSPs—for future service. It is a traditional indexed DB plan, long the hallmark of unionized workforces, is being reconfigured into new forms of retirement savings.

FIGURE 1: MAJOR WAGE SETTLEMENTS BY SECTOR

<table>
<thead>
<tr>
<th>Year</th>
<th>Average annual increase in base wage rates over duration of contract</th>
<th>Annual change in consumer price index</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public sector employees</td>
<td>Private sector employees</td>
</tr>
<tr>
<td>2007</td>
<td>3.4</td>
<td>3.3</td>
</tr>
<tr>
<td>2008</td>
<td>3.5</td>
<td>2.5</td>
</tr>
<tr>
<td>2009</td>
<td>2.5</td>
<td>1.8</td>
</tr>
<tr>
<td>2010</td>
<td>1.6</td>
<td>2.1</td>
</tr>
<tr>
<td>2011</td>
<td>1.7</td>
<td>2.1</td>
</tr>
<tr>
<td>2012</td>
<td>1.7</td>
<td>1.6</td>
</tr>
</tbody>
</table>

Note: Major settlements are those involving bargaining units of 500 or more employees

Sources: Strategic Policy, Analysis and Workplace Information Directorate, HRSDC, and Statistics Canada

In unionized settings, employees and their bargaining agents have traditionally resisted making concessions on pension benefits, and it took the severe financial pressures of the 2008 economic crisis (and, in some cases, a strike or lockout) to change this perspective.

In recent years, there has been greater acceptance of CAPs by unions, most notably where such plans are implemented only for new hires. While this approach generally means longer time horizons for the employer to achieve cost savings, it signifies a major concession by unionized workers. Such plans are now found in many sectors, including mining, brewing, manufacturing and transportation.

In successfully fighting to protect hard-won benefits for existing employees during collective bargaining, some unions have agreed to concessions on wage and benefits packages for future employees, in the hope of saving jobs and regaining ground in the years to come. The 2012 agreement reached between the Canadian Auto Workers (CAW) and the “big three” U.S. automakers is a high-profile example of a two-tier compensation structure. Under this deal, new hires start with a lower package of wages and benefits, phasing in to full compensation after 10 years. A mandatory DC provision has been added, and the flat-dollar contributory DB plan initially provides a lower benefit rate, which rises to half of the rate for existing members after 10 years.

Another example of this hybrid (DB/DC) design for a CAW-bargained plan is the 2011 Air Canada arbitration decision, which resulted in a reduced DB benefit for new hires, supplemented by a DC plan. The resurgence of two-tier wage and benefit structures illustrates the tremendous stress that today’s economic uncertainty is putting on employers and unions alike.

Preparing for Negotiations
Employers that have successfully reduced their pension costs through collective bargaining have used a variety of strategies. Laying the groundwork through effective advance communication with union leadership and employees is critical. And helping plan members to understand the impact of the DB plan on the corporation’s financial statements and cash flow is an important first step.

Before entering negotiations, employers should do the following:

• know their history of benefit improvements relative to inflation and wage increases;
<table>
<thead>
<tr>
<th>Age</th>
<th>DB plan</th>
<th>DC/group</th>
<th>RRSP only</th>
</tr>
</thead>
<tbody>
<tr>
<td>40+</td>
<td>48%</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>40s</td>
<td>46%</td>
<td>29%</td>
<td></td>
</tr>
<tr>
<td>50+</td>
<td>50%</td>
<td>33%</td>
<td></td>
</tr>
<tr>
<td>40+</td>
<td>62%</td>
<td>30%</td>
<td></td>
</tr>
<tr>
<td>40s</td>
<td>77%</td>
<td>41%</td>
<td></td>
</tr>
<tr>
<td>50+</td>
<td>77%</td>
<td>50%</td>
<td></td>
</tr>
<tr>
<td>40+</td>
<td>53%</td>
<td>45%</td>
<td></td>
</tr>
<tr>
<td>40s</td>
<td>77%</td>
<td>58%</td>
<td></td>
</tr>
<tr>
<td>50+</td>
<td>83%</td>
<td>86%</td>
<td></td>
</tr>
</tbody>
</table>

Note: Percentages indicate responses of somewhat agree or strongly agree

Source: Towers Watson 2011/12 Retirement Attitudes Survey

- conduct financial modelling of the proposed changes in different scenarios;
- know how their current and proposed benefits packages relate to their market comparators;
- assess, at least in broad terms, the plan administration and governance implications associated with proposed amendments; and
- anticipate the reaction of stakeholders such as unions, employees, retirees, investors, creditors, regulators and media, and develop an appropriate communications strategy.

To accomplish this, employers need the tools, information and capability to do the following:
- assess the current state of their labour costs relative to their business plan;
- monitor potential changes in costs under alternative scenarios;
- benchmark how their costs/risks compare to industry norms;
- develop and test alternative program designs and approaches to optimize overall cost and risk; and
- manage a multi-faceted communications strategy that may involve diverse audiences.

Weighing the Options
- e collective bargaining environment in recent years has been heavily influenced by employers’ desires to constrain labour costs, improve productivity and better manage their financial risks. Less attention has been paid to the role of pensions in such areas as recruiting, retention and talent management. An employer’s bargaining objectives should also be informed by its HR strategy.
- e are often significant gaps between the cost of a reward and its perceived value by employees. A total rewards optimization study can help employers to assess the importance that employees place on certain pay and benefits options relative to alternative approaches, thereby identifying which trade-offs employees may accept without damaging their engagement level.

Public Sector Trends
In the public sector, where retirement benefits may not be directly bargained but are often negotiated through jointly sponsored or jointly governed plans, both employers and plan members have been forced to consider whether they can afford the contributions now required to maintain current benefit levels. For example, the Alberta Local Authorities Pension Plan (LAPP) has undertaken a sustainability planning review that, among other priorities, seeks a combined employer/member contribution rate that will not exceed 25%.

Recent reports by the C.D. Howe Institute, the Institute for Research on Public Policy and other industry experts have shone a light on the unfunded liabilities of public sector plans and commented on the need for comprehensive reform, particularly with respect to the federal public service superannuation plan. A federal government enacted legislation last year to move to fifty-fifty cost sharing for future service benefits under that plan by 2017 while raising the normal retirement age and reducing early retirement benefits for public sector employees hired after 2012.

Efforts to stabilize employer contributions and attain fifty-fifty cost sharing have also been undertaken in the provincial and municipal sectors. This was a key feature of the 2012 collective agreement between the City of Montreal and its blue-collar workers, which resulted in increases to employee contributions and the establishment of a city-funded stabilization fund for the past service liability. It has also been a primary theme of recent pension reviews in Ontario and New Brunswick. Both provinces are exploring plan consolidation as a means to better manage costs and risks, and to achieve greater economies of scale. A 2012 report Facilitating Pooled Asset Management for Ontario’s Public-Sector Institutions proposed consolidating most public sector pension and investment funds into a new pooled asset management framework. A Ontario government subsequently reached five-year deals with the Ontario Public Service Employees Union (OPSEU) Pension Plan, the Healthcare of Ontario Pension Plan and the College of Applied Arts and Technology Pension Plan to freeze contribution rates—except in exceptional circumstances—and to address new funding shortfalls through reductions to future benefits. A is deal, which exempted the OPSEU Pension Plan from the proposed fund consolidation, sealed the union’s support for the recent collective agreement, which includes a two-year wage freeze.

In the private sector, there continues to be a focus on incremental changes that can optimize benefits, reduce costs and improve the employee experience. A key strategy is to focus on the areas where employees report the greatest level of dissatisfaction with their plan design and to use this feedback to help shape future modifications. It is also being recognized that employers need to be able to make changes to their plans with a reasonable degree of certainty. As a result, there is increased focus on how to deal with unfunded liabilities and the need to continue to invest in pension management expertise.

In many cases, employers are looking at how they can provide employees with greater predictability and influence over their retirement outcomes while also providing employers with greater predictability and influence over employee retirement patterns than is generally possible in a CAP. While switching to a CAP design may reduce cost volatility, it can also open up other cost issues. An employer’s ability to retire under a DC plan relies heavily on the capital markets leading up to his or her intended retirement date. Volatile investment returns and charges to

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Though CAPs remain uncommon in the broader public sector, concessions have been made with respect to ancillary benefits such as indexation and early retirement benefits. For example, the sponsors of the Ontario Teachers’ Pension Plan announced in February that inflation protection for future service will be fully conditional on the plan’s ability to pay for this benefit. It has established a task force, facilitated by Harry Arthurs (who chaired the Ontario Expert Commission on Pensions) to study a broad range of issues related to changing demographics and intergenerational risk. Both the LAPP and Teachers’ are also surveying members regarding possible strategies should funding shortfalls persist.

**The Path Ahead**

A positive outcome of the pressures facing many public sector pension plans may well be the forging of new paths to sustainability for all DB plans and increased options for private sector employers. With governments at all levels now engaged in seeking approaches to better manage the costs and risks inherent in the plans that they sponsor, there is an opportunity to advance solutions that may also be attractive in the private sector, particularly in unionized settings.

The emergence of new designs, such as target benefit plans, which lessen employer risk while retaining some of the attractive features of traditional DB plans, is a hopeful sign.

Yet a shift to CAPs has clearly occurred in the private sector. With economic circumstances favouring their success at the bargaining table, more employers will likely seek to introduce these arrangements for their remaining unionized plans.

Pensions represent a significant component of the total labour costs for many organizations and a significant asset for many Canadian workers. With so much at stake, there will be continued debate and intense negotiation over pension benefits for unionized workers in the months and years to come.

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**The traditional indexed DB plan...is being reconfigured into new forms of retirement savings**

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