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For immediate distribution – March 10, 2011

NEWS RELEASE

Defined-benefit pensions vulnerable to employer insolvency

Pension guarantees not first step in improving pension protection

Montreal – Current pension regulation does not provide full protection for defined-benefit pensions since it allows – and often incites – plan underfunding, according to a new study published by the Institute for Research on Public Policy (IRPP).

In the study, *Is Your Defined-Benefit Pension Guaranteed? Funding Rules, Insolvency Law and Pension Insurance*, author Ronald B. Davis warns that regulations often encourage actuarial and management practices that lead to questionable risk-taking in pension asset investment. This can pose serious problems for plan members if the sponsor becomes insolvent.

In high-profile cases such as Nortel Networks and Abitibi-Bowater Paper, the pension plan sponsors became insolvent and were unable to pay the pension benefits earned by workers and retirees. Parliament has since introduced bills to give higher priority of payment for claims against the plan sponsor for unremitted pension contributions. However, most asset shortfalls are due to other factors such as depressed asset values, and these cannot – and should not – be addressed by insolvency laws.

Pension benefit guarantee schemes are often proposed as a panacea for protecting pension entitlements. However, Davis argues that for such schemes to be effective, basic pension regulation first needs to be reformed. In particular, he recommends joint governance of pension plans by sponsors and members. In addition, he advocates expanding target-benefit plans.

“Joint governance is a better model for pension funds, because it recognizes that funding deficiencies will impact plan members if the employer becomes insolvent,” argues Davis. “There has to be a conversation among stakeholders about the risks and costs of defined-benefit pension plans, before we get into any pension guarantee scheme,” he adds. “Presently these risks are hidden from many plan members, and so they see it as guaranteed until their employer becomes insolvent. Target-benefit plans will help people acknowledge the trade-off between the financial risk and the costs of benefits,” he concludes.

Is Your Defined-Benefit Pension Guaranteed? Funding Rules, Insolvency Law and Pension Insurance, by Ronald B. Davis, can be downloaded free of charge from the Institute's Web site (www.irpp.org).

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