



Report of the

**SUB-COMMITTEE ON
CANADIAN NATIONAL
RAILWAYS' PENSION
SYSTEM**

of the Standing Committee
on Transport

May, 1986

Pat Nowlan, Chairman
Standing Committee,

Vince Dantzer, Chairman
Sub-committee

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HOUSE OF COMMONS

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Tuesday, April 22, 1986

Le mardi 25 mars 1986
Le jeudi 10 avril 1986
Le mardi 15 avril 1986
Le mardi 22 avril 1986



Chairman: Patrick Nowlan

Président : Patrick Nowlan

*Minutes of Proceedings and Evidence
of the Standing Committee on*

*Procès-verbaux et témoignages du
Comité permanent des*

Transport

Transports

RESPECTING:

CONCERNANT :

Organization Meeting
Sub-committee on C.N.R. Pension System

Séance d'organisation
Sous-comité sur le régime de pensions du CN.

INCLUDING:

Y COMPRIS :

Seventh Report of the Standing Committee
Sixth Report of the Sub-Committee

Le septième rapport du Comité
Le sixième rapport du Sous-comité

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First Session of the
Thirty-third Parliament, 1984-85-86

Première session de la
trente-troisième législature, 1984-1985-1986

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Clerk of the Sub-Committee

N.B. Thérèse Killens also served on the Sub-Committee.

NOTA : Thérèse Killens a participé aux travaux du Sous-comité.

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ORDER OF REFERENCE

ORDERED,—That the following Members do compose the Standing Committee on Transport:

Members: Angus, Belsher, Benjamin, Clifford, Cochrane, Gray, (*Bonaventure—Îles-de-la-Madeleine*), Nowlan, Reid, Robichaud, Taylor, Tobin — (11)

ORDERED,—That a Sub-committee composed of five (5) members including three (3) members of the Progressive Conservative Party, one (1) from the Liberal Party and one (1) from the New Democratic Party, be constituted in order to consider the Order of reference of Wednesday, April 17, 1985 relating to the Canadian National Railways' pension system.

That the Sub-committee be empowered to examine, inquire into and report to the Standing Committee on the subject matter relating to the Canadian National Railways' pensions not later than September 17, 1985.

That the Sub-committee be empowered to send for persons and records, to sit while the House is sitting, to sit during periods when the House stands adjourned, to print from day to day such papers and evidence as may be ordered by it.

That the Sub-committee have the power to retain expert, professional, technical and clerical staff.

ORDERED,—That, pursuant to the Sub-Committee's Order of Reference dated Tuesday, May 28, 1985, that the deadline for submitting the final report of the Sub-Committee on Canadian National Railways' Pension System to the Standing Committee on Transport be extended to Friday, April 11, 1986.

The Standing Committee on Transport
has the honour to present its

SEVENTH REPORT

In relation to its Order of Reference of Wednesday, April 17, 1985 respecting the Canadian National Railways' Pension System, your Committee has delegated the study to a Sub-committee.

The Sub-committee's report is as follows:

The Sub-committee on the Canadian National Railways'
Pension System of the Standing Committee on Transport
has the honour to present its

SIXTH AND FINAL REPORT

In accordance with its Order of Reference dated Tuesday, May 28, 1985, your Sub-committee has considered the issue before it and submits the following report.

ACKNOWLEDGEMENTS

Our Sub-committee has heard testimony from a cross-section of Canadian National Railways and railway pensioner groups and individual pensioners and survivors, as well as from the Canadian National Railways and Canadian Pacific Rail themselves. We wish to extend thanks to the witnesses who appeared before us in Vancouver, Winnipeg, Moncton and Ottawa and especially to the Canadian Railway Employees Pension Association and the National Council of CN Pensioners Associations Inc. who have been working for years on this particular issue (see Appendix C). We are also grateful for the considerable number of briefs, letters, and other written information we have received from railway pensioners and other interested persons (see Appendix D). The testimony we have received has been invaluable, and has been a major tool in the preparation of this Report.

The Sub-committee acknowledges with thanks the excellent work of its staff. In particular we thank our Clerk, Diane Tremblay-Bernier, who managed the administrative, financial and logistical underpinnings of the study, and our central research team, on whom we relied to analyze the evidence and draft our report: R. David Radford, Study Director, Mildred J. Morton, of the Library of Parliament, Legal Counsel and Research Associate, and David R. Brown of Eckler Partners Limited, our actuary. We also thank Hart D. Clark who provided us with important background information.

When the Sub-committee began its work we asked officials from Canadian National to give us an initial briefing. We are grateful for their presentation, and for their gracious cooperation in meeting our many demands for factual information about the Canadian National Railways' Pension Plan.

We wish to express our appreciation to federal officials from the Department of Insurance who willingly gave us their time and provided much-needed information.

Finally, the Sub-committee would like to thank the staff of the Committees and Private Legislation Directorate, Isabelle Des Chênes, secretary to the Sub-committee Clerk, the Translation Bureau of the Secretary of State Department and the other services of the House of Commons that have provided administrative and technical support.

**Sixth and Final Report of the Sub-committee on
Canadian National Railways' Pension System
of the
Standing Committee on Transport**

PREFACE

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PREFACE

The CN Pension Plan is one of the larger pension plans in Canada. At the end of 1984 its assets totalled about \$3.7 billion. Its operations affect the lives of many people: CN employees, CN pensioners and their survivors.

This Sub-committee is by no means the first group to examine CN pension arrangements. In 1969 as a result of great employee and pensioner dissatisfaction with certain actions of CN regarding the Plan, the House of Commons Standing Committee on Transport and Communications was given a reference to study the financial structure of the Railway and the Pension Fund. In 1973 a dispute arose between railroad unions and management, involving significant increases to plan benefits, among other issues. A Conciliation Board headed by Mr. Justice F. Craig Munroe was set up to bring about an agreement between the parties. The Board addressed important issues about the costs of the disputed benefits and how the determination of costs should be considered in the bargaining process. Later that year the Minister of Labour appointed Professor John J. Deutsch as head of a one-member Commission to inquire formally into the cost of the disputed plan amendments. Professor Deutsch provided an independent determination of the costs and the wage value to employees of pension improvements for the life of the collective agreement, as well as the effect of proposed changes to the Canada and Quebec Pension Plans on these costs.

However, pensioner and employee concerns regarding the CN Plan did not abate after all this activity. As a result, in 1975 the Minister of Labour set up another one-member Commission headed by Dr. Noel A. Hall to undertake a comprehensive inquiry into the benefits, financing and administration of both the CN and CP Plans. Dr. Hall submitted his report in 1976. The Report made two recommendations with respect to the CN Plan: that the trusteeship of the Plan be taken away from CN and put into the hands of a trust company, and that a 1% payroll tax be levied on CN and CN employees to provide a fund —

called by Dr. Hall a "Heritage Fund" — to provide full cost-of-living increases for current pensioners and their survivors. Neither recommendation was implemented.

From 1976 onward, Parliamentary standing committees have continued to hear from pensioners and pensioner groups. Pensioners forcefully presented their concerns to the House of Commons Task Force on Pension Reform in 1983.

Though we are not the first to deal with the CN Pension Plan we hope, with respect to some issues, to be the last. We have tried to explore pensioner concerns as thoroughly as possible. We feel that some are without foundation, and we attempt to explain how we have come to this conclusion as clearly and as carefully as possible. We have also provided a considerable amount of background information for the general reader, who is as likely to be as unfamiliar with the intricacies of pension arrangements and the complexities of the CN Plan as we were when we started our study.

We especially want to express our respect and admiration for the pensioners who sent us briefs and letters and who appeared at our hearings. We hope our Report is worthy of their concern, their energy and their determination.

CHAPTER ONE

Description of the CN Pension System

1-1 In reading the material before us, the briefs and presentations made both to this Sub-committee and to those who have addressed the issue in the past, it becomes clear that very few Pension Plan members, either active employees or pensioners, understand their pension arrangements. We do not blame Plan members for this. In another chapter we will discuss what we perceive to be the reasons for the confusion, and what can be done to improve the situation. However, because there is so much misunderstanding about the CN pension system, and some familiarity with it is necessary if the problems are to be understood, we think it important to describe some of its elements: the two plans which make it up, the benefits they offer, and the way benefits are funded and administered.

1-2 There are two CN Pension Plans. One, called the 1935 Plan, was established in that year. The other was established in 1952 as part of the 1935 Plan. Because it was revised in 1959, it is known as the 1959 Plan. The 1935 Plan was essentially a voluntary plan; employees could choose to contribute to it or not. Since 1959 all those hired by CN have had to become members of the 1959 Plan. At the end of December 1984 there were 893 employees enrolled in the 1935 Plan, and 1,057 pensioners or their survivors receiving benefits from the Plan. As of the same date there were 63,741 employees enrolled in the 1959 Plan and 43,294 pensioners or survivors receiving benefits from it.

1935 Plan — Retirement Benefit

1-3 The 1935 Plan provides two retirement benefits. There is a basic pension of \$25.00 per month upon retirement at age 65. All 1935 Plan members receive this benefit without having to contribute anything to the Plan. The more substantial

retirement benefit is an annuity, that is a series of payments which are provided by a lump sum. The amount of the lump sum, and the pension payments, depend on voluntary contributions to the Plan. Employees may contribute an even percentage of their earnings each year, to a maximum of 10%. CN is in turn obliged to credit to the employee's pension account an amount equal to these contributions up to 5% per year. It should be noted that until 1947, CN was not required to match employee contributions for the first 10 years of service. The lump sum to be annuitized is equal to the sum of employee contributions together with compound interest, and the amounts credited to the employee's account by CN together with compound interest at the same rate. Interest on accumulated employee contributions is not determined by the interest actually earned on these contributions, rather, it is set by the CN Board of Directors. The Plan guarantees that in no case will interest credited be less than the average return on long-term Canadian government bonds minus 1/4%, as assessed and recalculated by the Board of Directors every 3 years.

1935 Plan — Survivor Benefit

- 1-4 When the employee retires, the member may choose to receive a pension with or without a survivor benefit, with payments guaranteed for a certain period or a pension which has both of these features. If the benefit lasts for the pensioner's life only it will be greater than the pension with the guarantee or the survivor feature. The Plan provides for a discretionary survivor's pension should the contributor die before reaching age 65, and for a pension to be paid to long-service employees who retire between ages 55 and 64, or retire because they are disabled.
- 1-5 The 1935 Plan could be described as a defined contribution plan because amounts which CN and the employees must contribute to produce the benefit are fixed. However, the Plan does not have all the characteristics of such plans, as will be explained in the section on funding which follows.
- 1-6 All but 53 active employees now enrolled in the 1935 Plan — that is, 840 employees — are not contributors to the Plan. Their only benefit when they retire will be the basic pension of \$25.00 per month. Contrary to what is implied in some of the briefs it appears that existing pensioners did not contribute to the 1935 Plan in great numbers. Enrolment figures for 1958 indicate that the Plan was not popular. In that year forty-nine percent of all CN employees were not contributing to any plan at all. About 70% of the employees contributing to a plan were contributing to the 1959 Plan rather than the 1935 Plan.

1959 Plan — Normal Retirement Benefit

- 1-7 The 1959 Plan is a more complicated arrangement. It is a defined benefit plan. That is, the benefits are fixed by a formula, although total contributions to the Plan are not. This aspect of the Plan will also be discussed in the section on funding. Since 1975 the benefit for an employee who retires at age 65, the normal retirement age, has been a "2% best average benefit", integrated with the Canada or the Quebec Pension Plans (C/QPP). Employees receive a pension equal to 2% of the average of their last

or best 5 years of earnings, multiplied by the total number of years of service to a maximum of 35 years. Integration with the C/QPP means that for years of service from 1967 on, when C/QPP benefits were first paid out, the 2% benefit is made up of both a company pension and the C/QPP for all earnings up to the maximum on which C/QPP is payable (this amount is called the Year's Maximum Pensionable Earnings or the YMPE). In the case of the CN Plan, the company benefit becomes 1.3% of earnings up to the YMPE, and 2% over that amount multiplied by years of service.

- 1-8 The Plan did not always provide a 2% benefit on retirement. The original provision was for a sliding scale benefit, which ranged from 1% for the first 20 years of service to 1½% for each year of service over 30. By 1965 the Plan was improved to provide a benefit of 1½% for all years of service. This provision was fully retroactive; that is, it applied to all years of service for anyone who retired in 1965 or later. (However, the benefit was also integrated with the C/QPP in 1966; the effect of integration was to set the CN benefit at 1% of earnings up to the YMPE for all years from 1966 on). In 1973 the benefit became an integrated 2% benefit retroactive to 1956. In 1975 the 2% benefit was made retroactive for all years of service. Both improvements were the result of union-management negotiations.

1959 Plan — Survivor Benefit

- 1-9 The 1959 Plan has a number of important supplementary benefits. There is a survivor pension equal to 50% of the retirement pension. This pension is not a voluntary option, it is part of the retirement benefit. The survivor benefit is also payable to survivors of contributors who die in service prior to retirement, and to common law spouses. However, it is not payable to spouses who marry the member within one year before retirement, or any time after retirement. If the spouse is more than 15 years younger than the contributor, the pension is reduced by 1% for each year of the difference above the 15-year limit. There is some provision for Plan members who leave no survivor or whose survivors are not eligible to receive the survivor benefit. For a period after the date of retirement; should the pensioner die within 10 years of retirement, some benefit will be paid to the estate. Of course this benefit is in no way equivalent to the survivor pension, which is payable for the survivors's lifetime regardless of when the contributor dies.

1959 Plan — Early Retirement Benefit

- 1-10 The Plan has two early retirement provisions. Employees who retire between ages 60 and 64 and who have worked for CN for 25 years or more receive a pension calculated in exactly the same way as the pension payable at age 65, the normal retirement age; the formula is not changed to reduce the benefit because the employee has retired earlier. Of course if the employee retires with less than 35 years of service, his benefit will be less than the maximum. The second provision is often called by pensioners the "earlier-than-early-retirement" provision. Employees who retire between ages 55 and 59 and who have worked for CN for 30 years or more receive a pension which is reduced. The reduction factor is the ratio of years of service to years of service plus the difference between 60 and the age at which the employee retires, so

that the minimum pension payable is 30/35 or about 86% of the unreduced pension. At present the average age of retirement at CN is about 62.

1959 Plan — Integration with OAS

1-11 Employees who take early retirement are not eligible for benefits under the public pension plans — the Old Age Security benefit (OAS) and the CPP pension, which are now payable at age 65. The 1959 Plan has a voluntary feature which allows those retiring early to bridge the gap somewhat by receiving a benefit which is initially higher than it would normally be and lower after age 65. This is known variously as “OAS bridging”, “OAS integration”, or “notching”. This feature of the Plan has been widely used; however there has been a great deal of misunderstanding about its operation among older pensioners. It should be noted that the QPP benefit may be paid from age 60 with an actuarial reduction. By federal-provincial agreement in December 1985, a similar arrangement for a flexible retirement age will be introduced into the CPP.

1959 Plan — Disability Benefit

1-12 The last benefit of the Plan to be discussed here is the disability benefit. It is payable to employees with 15 or more years of service who must retire as a result of disability. As defined by the Plan, a disability is a disorder which prevents an employee from being unable to do his or her usual job, and may be a physical or mental disorder. A CN medical officer determines whether an employee is disabled or not. The pension is calculated in the same way as the retirement pension, without reduction. Again, though, the benefit will be calculated on the basis of fewer years of service.

1959 Plan — Buying Back Years of Service

1-13 In 1970 CN employees who had not enrolled in the 1959 Plan at its inception were given the opportunity to join the Plan and to buy back those years of service to which they had not contributed. In 1978 all employees in the 1935 Plan were actively encouraged to join the 1959 Plan by their unions and by CN. In 1979 the unions negotiated the buy back of 120 months (10 years) of service for all members who had joined the Plan in 1978, and in 1982 they negotiated the buy-back of all remaining years of service for those members who had accepted the 1979 buy-back. In many cases the decision to buy back service cost employees large sums of money, over and above amounts they may have paid into the 1935 Plan. A number of employees do not understand how these costs were calculated.

1959 Plan — Vesting and Portability

1-14 Most CN employees are long-service employees who stay with the company until they retire or are forced to retire because of a disability. There are separate plan

provisions for employees who leave CN before retirement. Only the 1959 Plan provisions will be described here.

1-15 Any employee who has worked for at least 15 years but who is under age 45 has the choice of taking his or her contributions out of the Plan with interest, or vesting the contributions, that is, receiving a pension calculated on the basis of years of service at the time the employee leaves CN. Contributions must be refunded on the employee's leaving CN with interest compounded at 3% up to 1976 and 4% after that. If the employee chooses to vest the contributions instead, the pension will be deferred — payable without reduction from age 60 on or with reduction from age 55 on. In a few cases, where what is called a "reciprocal transfer agreement" has been negotiated between CN and another employer, it will be possible to transfer the contributions credited to the employee to the pension plan of the new employer. Such agreements exist between the CN and the federal public service and a number of Crown corporations. However, there is no guarantee that amounts transferred on account of the deferred benefit will "buy" the same number of years of service in the new pension plan. This is another feature of the CN plan which has not been well understood. Proposed federal pension benefits legislation introduced in December 1985 will substantially change these vesting and portability provisions.

1-16 The present *Pension Benefits Standards Act* (PBSA) requires the contributions of any employee to be automatically vested if the employee has worked for at least 10 years and is age 45 or over when he or she leaves CN. This means that the employee does not have the choice of taking back contributions. Employees who are not old enough or have not worked long enough to be eligible for a vested pension receive their contributions with interest.

The Funding Process

1-17 To fund a pension plan is to make some sort of arrangement for financing the promised benefits. **Funding does not necessarily involve the existence of a fund: an employer might choose to pay the benefits owing each year out of available revenue.** This is risky for plan members, since there might not be enough income in any one year, or the employer might go out of business. In either case pension payments would stop, temporarily or permanently. Despite the possibility of this happening there was no legislation in Canada which required employers to create a separate fund for pension benefits and ensured the solvency of the fund, until Ontario passed the *Pension Benefits Act* in 1963. There was no comparable federal legislation until 1967 when the *Pension Benefits Standards Act* came into force.

1-18 In order to discuss CN's funding arrangements intelligibly it is necessary to set out some of the principles behind the funding of pension plans. In the case of an arrangement such as CN's 1935 Plan, building a fund is not a problem. The fact that the contribution is defined determines the funding process; all the employer has to do is to make the agreed contributions annually and invest the money. Indeed, a defined contribution plan is ordinarily characterized as one which imposes an obligation on the employer to fund in this way.

- 1-19 Funding a defined benefit plan is more complicated. There is in fact no feature to define a funding arrangement, only a defined benefit formula, which provides no direction at all. For each employee the employer is liable for an amount that is indeterminate until the employee retires or leaves the firm (at that time earnings and years of service are known), and is not completely determined until the employee and survivor have both died. As a result, the calculation of plan costs and the determination of a reasonable method of providing for these costs year by year involves making estimates on the basis of actuarial assumptions.
- 1-20 One must make assumptions about the workforce, its size, the number of employees who will stay until retirement or be eligible for a disability pension, or who will leave but will still be entitled to a deferred benefit. Because the benefit is based on best average earnings, assumptions must be made about what these earnings will be. This in turn entails a range of economic assumptions about the firm's productivity, perhaps the country's productivity, inflation and its effect on wages. Mortality assumptions are necessary since the benefit must be paid out over the lifetime of the employee and survivor.
- 1-21 Most of the benefits will be paid many years after funding decisions are made. This requires an assumption about the value of the accruing contributions in relation to the value of the benefits when they are actually paid. What is fundamental to this particular assumption is the fact that the cost of paying out future benefits will be less than the cost of paying out the same benefits at the present time, since the accruing contributions will earn interest. Another way of saying this is that the cost of future benefits should be discounted if they are to be expressed in terms of their value today or "present value". For this reason, this particular assumption must be thought of in two ways: as a discount rate assumption, because it represents a belief about the present value of the future benefit and the future accruing contributions; and as an interest rate assumption, which is the way it is most often described. This assumption together with the wage-inflation assumption are the most important assumptions in the funding process. If either is increased even by 1%, the determination of the present value of the benefits will change significantly, as will the amount needed to fund the plan.
- 1-22 The assumptions which form the basis of funding decisions are educated guesses about the future. The only thing certain about them is that they are likely to be wrong. It follows that they must be regularly tested against experience, and changed if there is reason to think that they are no longer appropriate. The process of valuation and change could be used for purposes which are other than that of ensuring a fit between assumptions and experience. For example, one might decide to set the interest rate assumption at a high level in order to reduce the contributions necessary to fund the plan. In Canada, opportunities for questionable actions of this kind are checked in two ways. First, the process is carried out by actuaries, who are professionals adhering to principles and standards which cannot be compromised by the firms which employ them. Second, pension benefits legislation provides for annual regulation of the funding process and administrative review of the valuation process every three years.
- 1-23 A second point to note is that there is more than one acceptable way to spread assumed costs over the lives of active employees. With respect to a plan to which

employees contribute, one such method could theoretically involve the employer matching employee contributions, as percentages of payroll. As a matter of fact, the most common funding methods for contributory plans do not involve employer matching. In most cases, an appropriate total yearly contribution is determined, employee contributions are subtracted from that amount, and the employer is liable for the rest.

1-24 One last point about funding is relevant to the discussion which follows. For some part of the life of a defined benefit plan, the plan will probably not be fully funded. That is, the liabilities of the plan (the present value of future benefits) will not be fully offset by existing plan assets. The portion which is not covered by assets is called the "unfunded liability". Two very common situations give rise to significant unfunded liabilities. First, there will be employees who worked for the employer before the plan was started, however normal funding methods are based on calculations from the date the plan is established or the date of entry into the plan, whichever is later. Also, improvements may be made to the plan which apply retroactively to years of service prior to the time change is made. The granting of credit for past service produces a funding discrepancy. These deficits must be funded apart from the ongoing method.

1-25 Reduction and elimination of an unfunded liability are governed by pension benefits legislation. The PBSA requires an unfunded liability arising from the establishment of a plan to be eliminated by payment of equal yearly amounts or fixed percentage of payroll within 25 years of the plan's starting date. There is an exception for all commercial Crown corporations, including CN, and for the CPR; they have been given 60 years, or until the year 2027, to pay off their initial unfunded liability. Unfunded liabilities resulting from plan improvements made after 1977 must be eliminated in 15 years, otherwise in 1992. In 1976 commercial Crown corporations were also given the choice of eliminating the total unfunded liability then existing by 2006. CN chose to do so. The PBSA refers to payments on the unfunded liability as "special payments". They are also known as "past service contributions", to distinguish them from "current service contributions" which apply only for each year of service after the date the plan was established or amended.

1-26 It should be noted that the amount of an unfunded liability is not fixed, but is relative to a plan valuation at a certain time. On later valuation a comparison of plan assumptions with experience might reveal that events have turned out less (or more) favourably than was assumed. The fund is then said to have an experience deficiency (or surplus). This will in turn increase (or decrease) the unfunded liability. As a result, larger (or smaller) payments will be needed to fund the plan. Pursuant to the PBSA, experience deficiencies must be amortized over 5 years.

1-27 If it is found that a plan assumption consistently fails to correspond with experience, there will be good reason to change it. If the assumption changes, the unfunded liability will change too. For example, if the interest rate assumption rises and the value of plan assets remains constant, the total liability and the unfunded liability (the difference between assets and liabilities) will fall. If the interest rate assumption falls, the total liability and the unfunded liability will rise.

Funding the CN Plans

- 1-28 Until 1960, CN did not contribute to the funding of benefits promised under the 1935 Plan during an employee's pre-retirement years. It did fund the benefit at retirement so that pensioners' obligations were fully funded. This method of funding is known as "terminal funding". Pension benefits legislation does not now permit it, but it was acceptable as a method until 1967. Employee contributions were placed in two trust funds, the "Annuity Trust Fund" and the "Supplemental Annuity Trust Fund" (which received contributions for the first 10 years of employment). The assets of these funds were kept separate from the revenues and assets of CN. Employee contributions were invested in Canadian government bonds. When an employee retired, CN paid into the funds an amount equal to that credited to the employee's account (including compound interest which was based on a notional rate guaranteed by CN). One effect of funding the 1935 Plan in this way was that as long as there were active members (non-pensioners) enrolled in the Plan, the Plan would have an unfunded liability.
- 1-29 As has been pointed out above, although the 1935 Plan involves a defined contribution, it is not, properly speaking, a defined contribution plan. Few pensioners knew that this was the case when they were active members; they assumed that CN made its contributions when they did and the interest credited was that actually earned. There is no indication that CN thought it necessary to explain how this more complicated arrangement worked.
- 1-30 In 1960, with the installation of the 1959 Plan as the dominant plan, CN adopted a funding method of the sort described for defined benefit plans above. Employees continued to contribute 5% of salary, which was now accounted for as part of the current service cost; CN contributed the remainder. Another trust fund was set up — the CNR Pension Trust Fund — into which CN contributions and employee contributions were placed. The Pension Trust Fund assumed the unfunded liability of the 1935 Plans as well as its own. At that time the unfunded liability of the 1935 Plan made up a little over 1/3 of the total. CN began to pay amounts into the Fund equivalent to interest on the unfunded liability at the valuation rate. However, CN made no formal commitment to amortize the unfunded liability and did not in fact make payments to do so. When the PBSA was passed in 1967, the Plan was changed to create an obligation on the part of CN to pay that part of the current service cost which was not paid for by employee contributions, and to amortize the unfunded liability as provided by the Act. There was no requirement in the Plan or otherwise that CN match employee contributions. In 1983 the two 1935 trust funds were amalgamated with the 1959 fund for investment management purposes only.
- 1-31 In 1960 the unfunded liability of the CN Plan was valued at \$325 million. It doubled during the next eight years. On the evidence before the Sub-committee this was primarily due to losses resulting from unanticipated wage increases. It also reflected the effect of improvements in the benefit formula. In 1968 the interest rate assumption was raised from 4% to 7½%, and a wage inflation assumption was introduced. As a result in 1969 the unfunded liability was reduced by \$371 million, that is, to about the initial level. From 1970 until the present, despite special payments, the unfunded liability has increased at each valuation and as of

December 31, 1984 stands at almost \$1.6 billion. The retroactive aspect of the 2% formula added more than \$247 million to that amount. In addition, since 1971 CN has made "ad hoc adjustments" to pensions in pay for all pensioners who retired before the 2% formula was fully introduced in 1975. (In 1985, for the first time an adjustment was made to the pensions of those retired in 1975.) These are permanent (lifetime) increases in benefits payable. Their total actuarial cost is \$338.6 million.

Administration of the CN Pension Trust Fund

1-32 The main administrative tasks with respect to any pension fund are the collecting of contributions, the investing of assets and the paying out of funds. If the fund is a trust fund, in Canada the common law of trust applies to these activities. This will mean, among other things, that fund assets must be kept separate from other assets, that persons designated as trustees are responsible and accountable for the entire administration of the fund, and that the trustees must act solely in the interests of those designated as beneficiaries of the fund.

1-33 Normally, the pension plan itself will set out the amount of employee contributions required, if any, and will indicate in a general way the nature of employer obligations for contributions. Actual amounts required from employers each year will be determined by the plan's actuaries. The PBSA regulates plan provisions and actuarial calculations to ensure that contributions will be adequate to pay promised benefits. It also regulates the process of paying in contributions to make sure that they are paid when due. The pension plan will probably have some provision relating to investments, which may be general or specific. There is a body of legal decisions which further specify the duty of trustees as investors. In addition, the PBSA sets out rules regarding the kind of investments a pension plan can make. Again, the intention of these provisions is mainly to ensure solvency and so a certain prudence in fund management. The paying out of funds — how much and to whom — is governed mainly by the plan itself.

1-34 In the case of the CN Pension Trust Fund the trustee is the CN itself, which acts through its Board of Directors. As with most pension trust funds, the administrative functions which are theoretically united in the trustee are in fact delegated to other bodies, in CN's case by company by-laws and the Pension Plan Rules. Investment policy and decision-making is handled by an Investment Committee appointed by the Board. Day-to-day investment decisions are made by a group called the "Investment Division". The administration of the Plan — the review of applications in order to assess the eligibility of the applicant for a pension, and the determination of the amount of the pension — is carried out by a Pension Board made up of 11 members. Three of the members must be pensioners. Since 1984, Plan Rules have provided for the appointment of one pensioner member who is not affiliated with either unions or management. There is no requirement that pensioners have a say in the determination of investment policy.

1-35 A number of points should be stressed about the powers of those who administer the Pension Fund. First, the powers of the trustees, and the powers of the various boards and officials which are derived from the trustees' powers, are limited, by

legislation, and by the provisions of the Plan itself and by common law. Second, although the Plan is a creation of the CN, which in theory can amend its provisions at will, changes to the Plan have been a bargaining item with the railway unions since 1973. It is highly improbable that any amendments which significantly affect active members could be made by CN alone. Third, the administrative structure gives pensioners very little opportunity to effect changes in the Plan which might benefit them or to oppose changes which might adversely affect them. It should be added that these restrictions are a common feature of pension plans and are not limited to the CN Plan.

CHAPTER TWO

Problems with the CN Pension Plan

2-1 In its submission to the Sub-committee, CN argued that its pension plan was adequate, if one judged adequacy either by comparing plan benefits with those of significantly similar companies, or by comparing the income which pensioners receive immediately after retirement to the income they receive before.

2-2 The pensioners who appeared before us did not think their pensions were adequate. A major problem for all pensioners is that the CN Plan is not indexed to the cost of living. This has meant that the average CN pensioner who retired just as inflation rates started to climb rapidly in the early 70's has seen the purchasing power of his CN pension cut in half. For a significant number of pensioners, the CN pension Plan, even together with OAS and C/QPP benefits, has not been able to provide an income that would allow them to avoid what they consider to be a serious disruption of their pre-retirement living standards after retirement — a criterion of adequacy which CN has cited with approval in its brief. In the words of one group of pensioners:

Most of the existing pensioners have put in something between 40 and 50 years of dedicated service with CN, and this kind of service is unique in industry in Canada. Although wage levels were not the highest, there was always a feeling that a steady rain soaks the deepest, and that they would be properly protected when they went on retirement. A very high percentage of retirees have paid significant premiums for all the years required by the pension Plan....

Recognizing all these factors, the pensioners cannot understand why the company will not provide a better income protection plan. Our association suggests that the quality of the ad hocing is about 30% to 35%, on average — that is to cover

inflation — for those who have received awards. However, you must remember that approximately 50% of the retirees have received little or no award. The resulting frustration is general, deep-seated, and bitter in some instances. [Minutes, Issue 9, p. 7.]

2-3 The absence of indexing which for pensioners means indexing to the Consumer Price Index (CPI) is not the only reason why pension benefits are low or are felt to be low. As we have explained in the first chapter, the 2% integrated benefit applies only to those pensioners who retired in 1975 or later. Those who retired before 1975, and there are a significant number, receive a CN pension calculated on the basis of a 1½% formula for most of their years of service. The benefit formula will be even lower for a pensioner who retired before 1965. Moreover, any pensioner who retired in 1966 or earlier receives no C/QPP. Because the C/QPP benefit was phased in over a period of 10 years, pensioners who retired in 1971 or earlier only receive between 1/10 and 1/2 of the maximum benefit.

2-4 Also, CN pension benefits, like those of most comparable defined benefit plans, are based not only on years of service, but on wages earned during those years. Throughout the 1960's, and especially in the 1970's, wages at CN increased rapidly. As a result, CN carmen retiring in 1970, to use one example, would likely receive a significantly lower CN pension than their counterparts who retired 10 or 15 years later. We must emphasize that this is not a problem which can be wholly solved by indexing benefits to the cost of living. As Table 2-1 shows, even if the CN Pension had been CPI indexed, pensioners' total pension income, including OAS and C/QPP (where applicable) would in many cases not have kept up with the average industrial wages (AIW). Since the average CN pensioner earned roughly the average wage before retirement, many of today's pensioners might well have experienced a significant drop in their standard of living between the time they retired and the present, even if their pensions had been CPI indexed. This is of course enhanced when there is no such indexing or the indexing is inadequate.

Table 2-1
Average long service pensioners total income (CN, C/QPP, OAS) at year of retirement and estimated indexed total income in 1985 as a percentage of AIW

	At retirement	1985
1960	58%	53%
1965	69%	66%
1970	81%	71%
1975	103%	105%

2-5 If a pensioner's income is low, the survivor's will be considerably lower. The CN Plan provides a survivor benefit which is 50% of the original pension. The C/QPP survivor benefit is 60% of the original if the survivor does not receive a benefit in his or her own right. A survivor receives only one OAS cheque. In short, a survivor receives just slightly more than half of what the couple received from the CN and public Plans.

2-6 Between 1971 and 1974, CN made adjustments to pensions in pay which applied to all pensioners (and survivors) except those retiring in those years. These were permanent — for life — increases in the pension benefit. But they were “ad hoc”, that is, there was no promise that they would be repeated in future years. As across-the-board increases they were clearly directed at the problem of inflation. From 1975 to the present, after the 2% benefit formula was made retroactive, the ad hoc adjustments continued but they took a new form. From then on (until 1985) they were directed at those who retired earlier than 1975. Also, larger adjustments were given to those who had been retired longest. This measure clearly recognized the special problems faced by those whose wages had been comparatively low, who did not receive a significant C/QPP benefit, and who did not benefit from the 2% formula, but ignored the problem of inflation for all those who retired after 1975. Since 1980, adjustments for surviving spouses have been set at 75% of the adjustment for pensioners, instead of the 50% which they had been previously, again to recognize the special needs of survivors.

2-7 These adjustments have not been enough. Table 2-2 shows how the average long-service CN pensioner has fared with respect to inflation alone.

Table 2-2

Retirement Year	Average annual CPI increase to 1985	Average annual Increase in CN Pension	Average annual Increases in Total Pension Income (including C/QPP and OAS)	C/QPP and OAS benefit as a % of total at retirement and in 1985
1960	5.7%	3.1%	5.2%	-/40
1965	6.8%	2.9%	5.2%	-/36
1970	7.8%	2.6%	4.6%	28/46
1975	8.3%	0.2%	3.1%	27/45

2-8 Pensioners have pointed out that many of their number receive pension incomes which are below the poverty line. Certainly, on CN's own evidence, someone who retired from CN in 1966 after 35 or more years of service may well be living below the poverty line. In 1985 the average CN Pension (including ad hoc adjustments) for those retiring in 1966 was about \$6,278 per year. The old age security benefit — about \$3,340 in 1985 — would bring this amount up to \$9,618. If the pensioner were married and the spouse also received OAS, the couple's total income from the CN and OAS would be \$12,958 in 1985. By Canada's most widely used definition of poverty, the Statistics Canada low income cut-offs (LICO's), this pensioner or couple would be poor, if there was no other source of income. For 1985, LICOs are estimated to be \$10,233 for a single person or \$13,500 for a couple living in one of Canada's largest cities; \$9,719 for a single person or \$12,814 for a couple living in a middle sized city (of up to ½ million people). A pensioner who retired 5 years later in 1971, and so was eligible to receive ½ the maximum C/QPP is in a slightly better position. On average this pensioner would receive about \$6,684 from CN. The public plans would bring this amount up to \$12,637 if the pensioner were single and \$15,977 if married.

CN pensioners have written to this Sub-committee and come before us in large numbers. They feel their pensions are inadequate. Pensioners raise other issues as well, and we will discuss these in later sections. In this section we have tried to set out some of the reasons why pensioners feel they way they do.

CHAPTER THREE

Pensioners' Claims

- 3-1 The financial statement of the CN Pension Trust Fund for the year 1984 shows invested assets of \$3.7 billion. Pensioners point out that the contributions regularly taken out of their wages form part of the Plan assets. To that extent, at least, pensioners claim an interest in the Fund. Many feel that amounts to which they may claim must be sufficient to ensure significant indexation of their pensions, and increased benefits for survivors and pre-1975 pensioners.
- 3-2 A number of pensioners make more specific claims with respect to the Fund, claims which call into question actions of CN in regard to the Fund. Many of these accusations have been put forward by members of the Canadian Railway Employees' Pension Association (CREPA) and especially by its President, Mr. Earl White. CREPA has been in existence since December 1971. It consists of 19 branches (4 active and the rest inactive) with a membership totalling 19,000 split equally between pensioners and active employees; CN and CP. It is the policy of the Association to bring its case before the federal Government and Parliament as forcefully as possible and to avoid any dealings with the railways whom they view as adversaries.
- 3-3 CREPA's position with respect to the activities of CN has circulated widely over the years. The Association's arguments were expressly reproduced or referred to in a significant number of the submissions we received; various aspects of these arguments were alluded to in many more submissions. A number of submissions made the point that CREPA's arguments have never been refuted and so they must be true. For this reason the Sub-committee has made an assessment of CREPA's views central to its study.
- 3-4 The Sub-committee has examined not only the CREPA briefs and testimony before us, but also evidence presented by CREPA to the House of Commons Task

Force on Pension Reform in 1983, and to the Standing Committee on Transport in 1982 and 1984. We have given CREPA and its adviser in actuarial matters all the information made available to us regarding the history and status of the Fund. In our hearings, we have through our own actuary, tested the merits of some of CREPA's positions, as represented by its actuarial adviser.

- 3-5 However, CREPA has not been the only pensioner association to question the activities of CN with respect to the Pension Fund. Another group whose arguments we think it important to address is the National Council of Canadian National Pensioners' Associations Inc. (National Council). The National Council was incorporated in 1974. It represents 4 regional and 32 local councils, some of which date back to the 1940's. At present through its associations the National Council represents about 15,000 CN pensioners. It is the policy of the National Council to work together with the CN for the benefit of its members. Since February 1984, the National Council President has been one of the three pensioner representatives on the CN Pension Board. This policy has been strongly criticized by the President of CREPA, a position which unfortunately divides people who are otherwise united in their goals.
- 3-6 The National Council's position is not essentially different from that of CREPA, but is complementary to it. The group approaches some of the same issues from a slightly different point of view, and deals with some different specific cases. For this reason we will discuss both sets of arguments together.
- 3-7 In the opinion of the Sub-committee, CREPA's position has two major themes. The first concerns the unfunded liability. It is CREPA'S argument that by allowing the Fund to incur an unfunded liability, CN has in effect borrowed money from the Fund, because CN was obliged to put in the money to cover the liability as soon as it arose. Since the total amount of the liability is a loan, CN should have been paying it back with interest at a rate comparable to that obtainable in the market-place. Since 1968, CN has been paying interest at 7.5%, a rate which in recent years has been considerably below rates available in capital markets. CREPA contends that CN's actions have deprived the Fund of monies which could have been used to help pensioners.
- 3-8 CREPA's second theme centres on the investment earnings of the Fund. In recent years, both the book and market rate of return on Fund investments has exceeded the interest rate used by the actuary as a funding assumption. CREPA argues that this must mean that there is more money in the Fund than CN needs to meet its obligations. This excess should be used to help the pensioners.
- 3-9 Underlying both these themes is the assumption that the Pension Fund belongs to pensioners, at least in part; to the extent that pensioners own the Fund, they have a right to the money which can be ascribed to their share.
- 3-10 CREPA makes a number of subsidiary points to support its position that there is or should be enough money in the Fund to improve pensions in pay. CN pensioners have always paid their contributions up front, as 5% to 6½% of salary (currently to a maximum of \$3,500 per year). CN should have made matching contributions. Although CN argues that their contributions to the Fund from 1960 to 1984 averaged

9.8% of payroll (only 6.8% in 1984), a large portion of that total is made up of payments on account of the unfunded liability. In CREPA's view these are in large part payments of interest owing to the Fund — payments on CN's debt to the Fund. They should be entered in the Fund's accounts as investment interest and not as pension contributions. CN has an obligation to match employee contributions for current service and if CN had done this, more money would have been available to the Fund now.

3-11 CREPA is critical of CN's using book value — that is, amortized cost — to measure the worth and earning power of the Fund's assets. If a market value measure were used, the Fund would be worth more than CN states it is and the extra amounts could be used to benefit pensioners.

3-12 Finally, CREPA raises an issue which has long been a sore point with CN pensioners and, at one time, with, active employees as well. In 1968, CN's actuary increased the interest rate assumption used to calculate funding requirements from 4% to 7.5%. As a result of the change in this assumption and others the amount calculated as the unfunded liability was reduced by \$371 million in 1969. (The total amount required to pay current service costs was reduced as well.) Why an increase in the interest rate assumption results in a decrease in pension costs is explained in Chapter One of this Report. Some pensioners feel that \$371 million was somehow extracted from the Fund by CN; it had been owing to the Fund and suddenly, as if by magic, it disappeared. This again, CREPA argues, is money which should have been in the Fund. Had it been, that amount together with accumulated interest could have been used to benefit pensioners.

3-13 An important corollary of all of CREPA's arguments is that CN has refused to acknowledge that there are amounts in the Fund, or has chosen not to turn over amounts to the Fund, which could be used for the benefit of pensioners. These actions of CN, or rather their failure to act, are presented as proof that CN is not capable of administering the Fund for its beneficiaries. (The activities of CN's actuaries and auditors who have reported on CN's pension plan financial statements have also come into question.) For this reason CREPA proposes that CN be removed as trustee of the Fund. This proposal is enthusiastically supported by many other pensioners. They also point to Dr. Noel Hall's conclusions on this issue in 1975:

I am of the firm opinion that the current trusteeship arrangements contravene the spirit (if not the letter) of the Department of National Revenue regulations concerning registered pension plans. I am also satisfied that the current trusteeship arrangements are contrary to the aims of the Pension Benefits Standards Act.

3-14 CREPA argues that CN has failed to do what it ought to have done. The group does not claim that CN has in fact abstracted money from the Fund and used it to its own advantage. Nor does CREPA seem to claim that CN has violated any law by failing to make what it considers to be necessary contributions to the Fund or by failing to use what it considers to be excess assets for the benefit of pensioners. Its position is that while CN's activities might well be legal, if they are, the laws must be changed to prevent CN from doing similar things in the future.

3-15 The National Council's arguments center around the unfunded liability. They argue that because CN is allowed to amortize payments to 2006, CN gains a benefit that employees do not have: the ability to reduce their total contribution by paying in inflation-reduced dollars. The National Council also argues that throughout the history of the Fund, CN has structured its affairs in such a way as to increase the unfunded liability. As a result CN has reduced its own costs by delaying payments and frustrated pensioners' claims by arguing that until the unfunded liability is eliminated CN can do nothing for pensioners.

3-16 In support of its arguments, the National Council points to evidence presented by CN itself in an appendix to their presentation. The evidence is summarized here in Tables 3-1 and 3-2.

Table 3-1
Contributions to the CNR Pension Trust Fund made
by CN and Employees from 1960 to 1984
(000 omitted)

	Employee Contributions	CN Contributions
Current Service	\$1,083,823	\$ 615,379
Past Service	* 134,280	**1,521,690
Total	\$1,218,103	\$2,137,069

* For employees this refers to amounts paid for buy-backs.

**For CN this refers to special payments on account of the unfunded liability.

Table 3-2
Contributions to the CNR Pension Trust Fund made
by CN on account of current service, 1980 - 1984
(000 omitted)

Year	Current Service Contributions
1980	\$ 54,246
1981	\$ 66,954
1982	\$ 70,090
1983	0
1984	0

3-17 Table 3-1 shows that the 70% of CN's contributions to the Fund have been on account of the unfunded liability. Because the amortization period is long, most of these payments have not yet gone towards reducing the "principal" but have just ensured that the principal is not increased. The National Council sees these payments as being made in cheap dollars.

3-18 From Table 3-2 it is clear that in 1983 and 1984 CN reduced to zero the contributions which it was required to make for current service. As the National Council points out, CN was able to do this as a result of a plan valuation for the year

1981, which was carried out at the end of 1983. This valuation revealed a surplus of \$126 million, which was used to reduce CN's contributions. What this means, the National Council argues, is that while CN chooses to spread the bulk of its pension costs over future years, it chooses to take immediate and full advantage of the favourable experience of the Fund by reducing its own operating expenses.

3-19 Like CREPA, the National Council does not claim that CN has done anything illegal. It recommends a number of changes to pension benefits legislation which are consistent with CREPA's proposals, including the requirement that CN's current service contributions be comparable if not equal to employee contributions. In addition it recommends that restrictions be placed on the ability of CN and other employers to amortize the costs of pension benefits.

3-20 The admission that CN's activities may be legal is an important qualification to the pensioners' position. The Sub-committee would like to emphasize that it has found that the CN has done nothing with respect to funding the Plan or paying benefits out of the Fund that other employers in Canada have not done. If laws must be changed to force CN to act in ways which pensioners propose, these laws must affect other employers as well.

3-21 The Sub-committee has thought it necessary to have an opinion as to whether the activities singled out by CREPA and the National Council are legal or not. The opinion is attached to our Report as Appendix A. Our legal adviser has concluded that none of these actions is illegal, with the possible exception of CN's retaining the role of trustee of the Fund after pension benefits legislation was introduced in 1967.

3-22 Like both pensioner groups the Sub-committee does not feel that the legality of CN's actions decides the issues before it. We must also consider whether these actions are in fact undesirable, and whether the law ought to be changed to reflect this conclusion. After much careful thought, the Sub-committee has concluded that no excess amounts are somehow hidden in the Pension Fund, and none are owed to the fund through omissions of CN as described by CREPA. We also conclude that the National Council is wrong in claiming that from the inception of the 1959 Plan, CN has manipulated its funding to its own advantage and the detriment of pensioners. We see no reason to recommend major changes to pension benefits legislation of the sort endorsed by both groups. However, we have also concluded that events in 1983 and 1984 show that CN does not have completely clean hands with respect to its treatment of the Fund, and we propose to make a recommendation in this regard.

3-23 Before dealing with the pensioners' specific arguments, we would like to discuss briefly the general claim that the Fund belongs to pensioners. It is generally accepted that pension benefits are deferred wages: in the long run employees give up present benefits (and, in contributory plans, a fixed percentage of their wages) in order to receive amounts when they retire. An employer must set up a fund to ensure that these benefits are paid. There is no doubt that in law this fund, like all trust funds, must be run for the benefit of the beneficiaries — the CN Plan members, which includes CN pensioners. But all these facts do not imply that pensioners — or actives or CN for that matter — own the Pension Fund in the ordinary sense of the word. Here we would refer the reader to the answers to question 1 in our legal opinion.

3-24 To own something in the ordinary sense is to be able to do what one wants with it, more or less. In this sense, one owns a savings account or an RRSP (subject to the restrictions imposed by Revenue Canada). However what control pension plan members have over trust fund assets depends solely on the terms of the trust and legislation governing the trust. As we have explained in the first section, it is CN as trustee which is responsible for investing Fund assets. CN is guided by Plan Rules, by general trust principles — for example to act on behalf of all Plan members, and to refrain from favouring one set of Plan members over another — and the specific investment guidelines set out by pension benefits legislation. It is also CN as trustee which is responsible for paying amounts out of the Fund, in accordance with the terms of the pension Plan, pension legislation, and whatever aspects of the common law of trusts are consistent with these two. If pensioners feel that CN has mishandled Fund assets they have a right, as beneficiaries, to ask CN to give back the amounts owing to the Fund, and even to ask the courts to dismiss CN as trustee. But pensioners cannot simply say to any trustee, whether it be CN or any other, as they could to the financial institution which holds their RRSPs: “We have contributed so much money over the years which has earned interest; it is our money, and we want you to pay it out in a way that benefits us.”

3-25 To return to the specific arguments of CREPA and the National Council, the Sub-committee does not accept CREPA's claims regarding excess earnings of the Fund, as set out in numerous CREPA briefs. It is true that in recent years the Fund has generated more money in interest than its interest rate assumption anticipates. However, the interest rate assumption is not the only one used to determine the cost of providing promised benefits. As we have pointed out in Chapter One, a number of other assumptions are also necessary: about the rate and extent of wage increases; the mortality rate of the Plan members, and so on. In each of these cases events may prove the assumptions to have been too conservative. But events may also prove one or another of the assumptions to have been overly optimistic, so that more money may be needed to fund the Plan than was assumed. Thus in assessing whether the assets of a plan are greater than are necessary to pay out benefits one must not only focus on the interest rate assumption and its relationship to actual interest rates; rather, one must assess all the assumptions and their relationship to experience. This notion of an excess with respect to a fund's actuarial assumptions is called an experience surplus or gain. It must be stressed that the result is relative to the specific actuarial valuation. Actuaries might at a later time compare the assumptions with experience and conclude that there is a deficit, an experience deficiency or loss.

3-26 We have reviewed the history of the CN Fund since 1960. In our view there has been no significant experience surplus in the Plan until 1980. CREPA has claimed excess amounts in the Plan since 1976. A review of the 1984 valuation, which covers the three-year period between 1982 and the beginning of 1985, shows an experience surplus of only \$29 million. As Table 3-3 shows, the amount of interest in excess of the interest rate assumption, which counts for most — though not all — of the experience gain, is offset by the unfavourable experience with respect to other assumptions, in particular the wage and salary assumptions. For these reasons we find CREPA's calculations and claims as to excess amounts in the CN Fund unacceptable.

Table 3-3

Estimated sources of experience gain or loss: 1982-84	\$ millions
1. Investment income for the 3 years in excess of 7% assumed	+ 386
2. Liability increase because of actual wages and salary increases higher than assumed	- 255
3. Liability increase resulting from the use of exact data on allowable service, instead of previous approximation	- 41
4. Higher than expected rates of disability and early retirement	- 50
5. Sundry gains and losses	- 11
	+ 29

(This table eliminates certain changes indicated in the 1984 valuation which we define as assumption and method changes.)

3-27 The Sub-committee feels that the arguments which center around the unfunded liability arise in part from a misunderstanding about the origin of the unfunded liability. Behind much of the discussion of this subject — both that of CREPA and the National Council — there is the implication that the unfunded liability of the 1959 Plan is the result of CN's practice of terminally funding the 1935 Plan, including the defined benefit provisions of that Plan which were introduced in 1952; or if not that, at least the implication that by allowing the unfunded liability to exist, CN is practicing a form of terminal funding, delaying payment until some date in the distant future. This is simply not the case.

3-28 As we have briefly explained in the first chapter, CN's unfunded liability arises mainly from 4 sources: the application of initial plan benefits and subsequent benefit improvements (especially the increase from 1.5% to 2.0%) retroactively to all years of service; the granting of ad hoc increases to pensioners; the decision to allow employees to buy back years of service in the Plan; and from experience deficiencies and assumption changes. Table 3-4 which has been developed by the Sub-committee's own actuary sets out the amounts which can be ascribed to these sources.

3-29 Pensioners are often incredulous when they see these amounts. They wonder how an ad hoc adjustment, such as the one granted in 1984, could be said to cost \$45.7 million when CN actually paid out to pensioners a total of \$6 million extra in that year. What is forgotten is that CN has so structured the adjustment that it is promised to the pensioners and survivors for the rest of their lives. The \$45.7 million represents the present value of these future payments.

3-30 **As a result of the benefit increases for actives and pensioners CN's own costs — amounts they had to contribute to the funding of Plan benefits — did not decrease, they increased and show up as past service contributions.** Employee contribution rates increased too, but only twice, from 5 to 5½%, the rate in effect between 1962 and 1964, and from 5½ to 6½% in 1965. These rates were not increased when the 2% benefit was introduced, nor as a result of the buy backs. Granted, the amount by

Table 3-4
CNR Pension Plan — History of Unfunded Liability 1960-1984

(All amounts in \$ millions)

Year	Unfunded Liability Balance, Beginning of Year	Liability Increases				Principal Payments by Company	Unfunded Liability Balance, End of Year
		Pensioner Increases (Ad hocs)	Other Benefit Changes	Experience Losses (Gains)	Changes in Actuarial Assumptions		
	\$	\$	\$	\$	\$	\$	\$
1961	325.0						
1962	325.0		41.0	22.3	6.7		395.0
1963	395.0						395.0
1964	395.0			49.0			444.0
1965	444.0						444.0
1966	444.0		97.0	94.0			635.0
1967	635.0			40.0		0.7	674.3
1968	674.3					2.9	671.4
1969	671.4				(371.0)	0.3	300.1
1970	300.1		42.8			0.6	342.3
1971	342.3	56.7				2.3	396.7
1972	396.7	19.2	44.9	47.4		4.6	503.6
1973	503.6	11.2	197.3			9.8	702.3
1974	702.3	23.6		31.6		12.0	745.5
1975	745.5	23.0	40.0			14.8	794.5
1976	794.5	22.3		121.5	145.5	25.1	1,058.7
1977	1,058.7	14.4				1.1	1,072.0
1978	1,072.0	15.5		43.8	128.0	20.0	1,239.3
1979	1,239.3	15.5	3.6			45.8	1,212.6
1980	1,212.6					41.7	1,170.9
1981	1,170.9	39.1	(28.4)	(333.6)	658.8	7.8	1,499.0
1982	1,499.0	26.0	76.0			18.9	1,582.1
1983	1,582.1	25.6		(109.7)		0.4	1,497.6
1984	1,497.6	45.7		(77.0)	47.5	(55.2)	1,569.0
		<u>337.8</u>	<u>514.2</u>	<u>(70.7)</u>	<u>615.5</u>	<u>153.6</u>	

which CN's contributions increased was less than it would have been had CN paid the cost of these adjustments immediately, or had amortized them over a shorter period of time. But it is arguable that if CN had been required to do either of these, the company would never have consented to the improvements and adjustments in the first place. Certainly CN intentionally increased the unfunded liability in these cases. But it did not do so to delay payments which it had originally undertaken to make; rather to spread out extra costs which it had assumed for the benefit of actives (who would be pensioners in the future) and current pensioners.

3-31 We now turn to the experience deficiencies and assumption changes. What follows is a simplified reconstruction of events on the basis of evidence submitted by CN. From 1960 to 1968 the Fund's interest rate assumption was 4%; there was no wage inflation assumption. During that period investment earnings rose from 4.38% in 1960 to 5.64% in 1968, but salary increases compounded at 5%. The result was a series of experience losses totalling \$205 million. In other words the pension liability — the total amount owing to pensioners and to actives when they came to retire —

was increasing faster than was originally assumed when contributions were set and investment earnings estimated.

3-32 The assumptions were reviewed in 1968, probably as a result of the introduction of federal pension benefits legislation, and in the light of unfavourable past experience. The interest rate assumption was changed to 7½% and a 4% wage inflation assumption was introduced. These changes reduced the assumed cost of Plan benefits, including the unfunded liability, and so reduced CN's contributions for the period of the valuation, since employee contributions were fixed. Is there a case for arguing that Plan actuaries, at CN's instigation, manipulated these assumptions to bring about these results?

3-33 With hindsight it is arguable that the 1968 interest rate assumption and wage inflation assumption were both overly optimistic. Investment earnings had grown since 1960, but only to 5.64% (however, earnings rates on new investments were higher than that figure). In the light of wage growth since 1960, the 4% assumption was at the lower end of a reasonable range. However, while CN did immediately benefit from the 1968 valuation, the experience of subsequent years went against the company. Wage inflation from 1969 to 1980 was 10% per year compounded, and investment earnings did not exceed 7½% until 1978. For this reason a total of \$244 million in experience losses was recorded for the years 1972, 1974, 1976 and 1978. (See Table 3-4.) These losses, which had to be amortized over 5 years, caused CN's contributions — both current and past service — to rise. In 1976 and 1978 Plan actuaries changed some assumptions, presumably to more permanently reflect unfavourable wage experience. This again increased Plan costs by \$273 million.

3-34 In 1980 for the first time the Plan showed an experience gain of \$333 million, 55% of which could be ascribed to favourable investment earnings. Notwithstanding this favourable experience the Plan actuary decided to strengthen the assumptions. The wage-inflation assumption was increased and the interest rate assumption lowered from 7½ to 7%, a change to the detriment of CN which CREPA has never recognized. This resulted in an initial increase to the unfunded liability of about \$659 million. The reduction in the interest assumption viewed by itself looks too conservative. Taken together with the wage-inflation assumption, it produced the desired strengthening: in calculating the pension liability the magnitude of the difference between the wage assumption and the interest rate assumption is more significant than the value of each assumption alone. Some of the experience gain under the old assumptions was used to eliminate all special payments on account of the 1977 and 1978 ad hoc adjustments and the 1978 experience deficiency, and also to reduce the special payment on account of the initial unfunded liability for the following year, 1981. The balance of the experience gain was subtracted from the deficiency which arose from the changes to the interest and wage assumptions. The net effect was an increase in the unfunded liability of \$392 million, and an increase in future special payments and current service costs, the converse of the situation in 1968.

3-35 To summarize, the assumptions of the 1968 valuation may be questionable and they did benefit CN in the short-run. However, other assumption changes, notably those in 1980, were made to CN's detriment. Moreover, experience deficiencies (not to mention the effect of increases in the benefit formula, ad hocs, and so on) restricted

CN's ability to take advantage of the cost reductions brought about by the 1968 valuation.

3-36 Another way of assessing whether pensioners are paying more than their fair share of the costs of their benefits up front, is to compare the actuarial cost of these benefits with the amount of contributions paid by the pensioner, accumulated at the earnings rate of the Plan. In its Summation before the Sub-committee in December 1985, CN produced a very rough approximation of such a calculation for the years 1970 to 1984, which we reproduce in Table 3-5, at the end of this Chapter. We have examined CN's material. We feel that it is a rough but fair attempt to determine how much employees have paid towards the cost of their benefit. We have done our own calculations based on figures submitted to us by one pensioner, who retired in 1975. We found them to approximate CN's own. According to CN's calculations, the contributions of pensioners retiring between 1970 and 1984 paid for no more than 32% of their benefit; in some cases pensioners paid as little as 24%. The Sub-committee feels that these numbers provide important evidence against pensioner claims. If anything they indicate that CN may have taken too great a burden upon itself in the light of its own financial performance.

3-37 For all these reasons, the Sub-committee cannot agree with CREPA that CN owes the Pension Fund an amount equal to the reduction in the unfunded liability in 1968. The Sub-committee cannot agree with the National Council that CN has consistently manipulated funding assumptions and the unfunded liability to its advantage. The Sub-committee views CN's contributions for past service as legitimate payments on account of the cost of pension benefits. It does not think that legislation should require CN to make more payments on account of current service in order to approximate amounts contributed by employees.

3-38 Moreover, the Sub-committee does not think that an unfunded liability should be treated as a loan, either in general or in the specific case of CN. To do so would be tantamount to requiring that plans be fully funded at all times, since there is no real difference between paying off the liability at current rates of interest or borrowing the money from a bank, say, and straightaway putting it into the fund. This would of course increase the size of the fund, and on pensioners' assumptions, the pensioners' share of the assets. But the other consequences of imposing immediate full funding on CN and other employers are not desirable.

3-39 For one thing, depending on the size of the unfunded liability, immediate full funding might harm the employer's ability to do business. Also, in many cases unfunded liabilities arise because a promised pension benefit covers years of service for which there were no contributions, or where previous contributions have failed to cover costs, as has been the case with CN. To require an employer to pay immediately the full cost of retroactive plan improvements, or of plan benefits for years of service when the plan was not in force, might well result in there being few additional improvements made, or might prevent employers from establishing defined benefit plans altogether. In CN's particular case, it can be argued in the light of its negotiations with the unions in the 70's that all parties understood exactly what the costs of improvements for the period of the collective agreements negotiated were and how they were going to be paid off. If there had been an understanding that CN would

pay the full cost immediately, the rest of the wage package would not have been negotiated as it was. It would not be fair to require that CN go to the market in order to pay off its unfunded liability sooner than was expected.

3-40 Last, the unfunded liability is not an amount fixed for all time. A bank loan is determined by the amount of money actually received by the debtor. An unfunded liability is an amount which actuaries, using certain assumptions, have calculated that is required to put the fund in the position to pay all benefits promised by the plan when due. If the assumptions change, or if events do not match the assumptions used, the unfunded liability will change. What amount then would it be fair to require an employer to put into the plan immediately? Moreover, if on a later valuation a surplus emerged, the fund would arguably have had a windfall at the expense of the employer. Should legislators take a position consistent with that of CN pensioners and provide that in such a case the money should be returned to the employer with interest at a market rate, since in effect it was money loaned to the fund by the employer?

3-41 We understand that our conclusions regarding the unfunded liability many seem paradoxical. If the unfunded liability is not a loan why does CN have an obligation to pay it? We would point out that not all obligations to pay money come about as a result of having borrowed the money. To give one example, separated and divorced spouses are obliged to pay for support of their children, because the law orders them to or because they have promised to. There are good reasons behind such legislation and behind the enforcing of these kinds of promises to pay. In an analogous way, pension benefits legislation requires employers to have a plan for eliminating their unfunded liabilities by amortizing them over a reasonable period. The reasons for this are to ensure that plan members will receive the benefits promised to them regardless of whether the employer continues in business. These are good reasons for requiring payments of the unfunded liability. They do not entail that payments should also be made at current interest rates. We do not feel that there are any reasons to extend the *Pension Benefits Standards Act* to do so.

3-42 **There are no hidden surpluses in the CN Pension Fund. CN has not misappropriated earnings by failing to pay proper rates of interest on the unfunded liability, or by failing to pay its fair share of Plan costs, or by the misuse of actuarial assumptions. CN's financial statements have not been misleading because they fail to record special payments as interest payments on the Fund rather than Plan contributions. That we make these findings does not mean that we have not understood what pensioners have been saying to us or that we lack compassion. We know that pension benefits have been severely eroded by inflation. We understand the situation of survivors and those pensioners who retired before benefits were improved in 1975. We understand that pensioners would try to show that the money for the improvements they seek has been in their Fund all along or is otherwise owing to them. Unfortunately, this is not true. Any recommendation that the Sub-committee makes to improve payments to pensioners will increase costs to the CN.**

3-43 All this being said, the Sub-committee agrees with the National Council that CN's decision to use the surplus revealed in the 1981 valuation to reduce their current service costs between 1983 and 1985 is unacceptable. If deficiencies in the Fund are spread out to CN's (and employees') immediate benefit, gains should be treated in a

similar way, and spread out over a period of time. We feel that this conclusion is applicable to all businesses under federal jurisdiction.

- 3-44 **3.1 The Sub-committee recommends that the Regulations of the *Pension Benefits Standards Act* require employers to apply an experience surplus to reduce or eliminate an unfunded liability first, and to apply the remainder if any, to reduce current service contributions.**

**Table 3-5
Portion of Pension Cost Shared by the Employee**

Retirement Year	Simulated employee contribution with interest at retirement	Employees share of cost of retirement pension
1970	\$10,958	30.7%
1971	\$12,053	31.4%
1972	\$13,142	31.9%
1973	\$14,390	27.6%
1974	\$15,854	27.3%
1975	\$17,684	24.2%
1976	\$19,762	24.3%
1977	\$22,078	24.4%
1978	\$24,510	24.8%
1979	\$27,345	25.4%
1980	\$30,768	26.2%
1981	\$35,317	27.4%
1982	\$41,461	29.1%
1983	\$48,016	30.7%
1984	\$54,290	32.0%

Assumptions:

- total associated railway unions average annual earnings were used
- employee contributions were credited with a rate of interest of:
 - 3% until 1960
 - long term Canada bonds after 1959
- cost of pension was determined using CN mortality and interest rate of 7%
- employees are assumed to retire at age 62 with 35 years of service

CHAPTER FOUR

A Solution for Current Pensioners and Survivors

- 4-1 The Sub-committee has rejected the majority of the pensioners' claims regarding the assets, investment earnings and funding pattern of CN's Pension System. However, we do believe that there are valid reasons for suggesting that CN should be paying more of the Fund's earnings to pensioners. We have reviewed CN's plan and have specific recommendations for change, in part along the lines suggested by CREPA's actuarial advisers.
- 4-2 CN's pension obligations, like those of most plans, cover three categories of members: those currently working for CN (actives); those who have retired from CN and are currently receiving pensions (pensioners); and those who have left CN but are entitled to a deferred pension (active deferreds). The *Pension Benefits Standards Act*, 1985, which is now before the House of Commons, will change the portability provisions for active deferred members in important ways. These changes will be discussed at the end of our Report in connection with reciprocal transfer agreements. Our proposals deal with funding for actives and pensioners.
- 4-3 Funding assumptions for actives differ significantly from those for pensioners. As we have pointed out, the funding pattern of benefits for actives depends mainly on two assumptions; the discount or interest rate assumption, and the wage-inflation assumption. When an employee retires, however, the benefit is fixed by the formula, and the major determinant of its cost — how much money is required now to pay the pension for the life of the pensioner and the survivor — is the assumed interest rate in the pension plan valuation. In fact the obligation for the pensioner could be removed from the fund at retirement by the purchase of an annuity for the pensioner from a life insurance company. The cost of the annuity would reflect the life insurance company's interest and mortality assumptions, and could thus be greater or less than that assumed by the employer. If this is not done, the fund (and the employer) continues to

assume the possible losses associated with the assumptions failing to conform with experience, but the fund (and the employer) will benefit by any gains from experience.

4-4 The arrangement just described involves a cross-subsidization of costs between active members and pensioners. Assets accumulated for both pensioners' and actives' benefits are a source of an experience gain if the investment earnings are higher than the assumed interest rate. But this gain may be subject to offset by losses relating to the wage-inflation experience, which is only relevant to the cost of benefits for actives. In fact, in 24 of the last 26 years, CN wages have risen far more than assumed, and have been a significant factor in reducing any gains arising from favourable investment experience.

4-5 The Sub-committee understands that cross-subsidization is a feature of defined benefit plans in general and the CN Plan is no exception. For example, Plan members who are unmarried at retirement subsidize those who are married (and have survivors who receive benefits). Similarly, male members of defined benefit plans subsidize female members, who live longer. Nonetheless, like the CN pensioners, we feel that inflation-induced investment gains should be used in part to benefit pensioners, whose purchasing power has been eroded by inflation, rather than lower the costs of providing benefits for actives.

4-6 **4.1 The Sub-committee recommends that:**

- (a) for valuation purposes the CN Pension Plan should be notionally split between actives and pensioners as of January 1, 1988: valuations should be made for these two groups on the basis of assumptions appropriate for each group; the interest rate and mortality rate assumptions for the pensioner fund should remain fixed as of the 1984 actuarial valuation, the assets of the Fund should remain intact;
- (b) the pensioner fund should bear a fair share of the unfunded liability;
- (c) because an experience gain in the pensioner fund would be a measure of the cross-subsidization which presently exists between actives and pensioners, the experience gain as defined in paragraph 4-9 should be used to adjust pensions-in-pay, including those of survivors;
- (d) any experience deficiencies in the pensioner fund relative to the 1984 assumptions should be made up by CN;
- (e) the amount of adjustment to pensions-in-pay should be consistent with a formula which gives amounts to present pensioners and survivors, in order to relieve some of the impact of inflation, but which gives larger amounts to those who retired before 1976, in order to take account of their particular situation;
- (f) because the experience gain will fluctuate, the decision to adjust pensions and the determination of the amount of the adjustment should be left to the discretion of the Plan trustees constituted according to our recommendation 6-1, on the recommendation of a sub-committee of the Pension Board, made up of pensioners and CN officials, as proposed in that recommendation;

- (g) the CN Pension Plan and other relevant documents should be amended to reflect these recommendations.

A number of these recommendations need elaboration.

Sharing the Unfunded Liability

4-7 The Sub-committee understands that there may be objections to ascribing a part of the unfunded liability to the pensioner fund. CN pensioners may argue that CN alone is responsible for its failure to fund, that this is not the pensioners' problem. We have set out our reasons for rejecting this argument in the third chapter of this Report. To repeat them briefly, we have determined that a good portion of the unfunded liability has arisen from the retroactivity of plan improvements, which benefitted all pensioners who retired after 1973 and most especially those who retired after 1975; and from adjustments to pensions-in-pay, which have benefitted all those who retired before 1976. Pensioner contributions did not go toward funding improvements insofar as they were retroactive.

4-8 There is another argument against our point of view with respect to the unfunded liability. If the CN Plan were terminated, all the assets would be first applied to ensure the payment of benefits actually being paid out; pensions-in-pay would not be reduced by some factor which reflected the existing unfunded liability. Therefore, the argument continues, no portion of the unfunded liability should be assigned to the pensioners' account. We do not accept this argument. We feel that considerations which govern the division of fund assets on plan termination should not govern the notional division of an ongoing plan. When a plan is terminated, the first concern should naturally be to preserve existing benefits: it is pensioners as a group whose lives would be affected the most by a reduction in their benefits. The consequences of applying a proportion of the unfunded liability to pensioners in an ongoing plan is not to reduce their expected benefits, but to reduce a possible source of increased benefits. While we think it is important that pensioners not be excluded from sharing inflationary gains, we do not feel that they should be completely relieved of the burden of paying their fair share of pension costs. Every pensioner was once an active; inasmuch as actives have been subsidized by the gains of a unified fund, current pensioners have also benefitted.

Pensioners' Share of the Experience Gain

4-9 The Sub-committee would like to point out the results of notionally splitting the CN Pension Fund (and the unfunded liability) with respect to the years 1982-1984. On the basis of the 1984 valuation our actuary has determined the total investment gain for those three years to be \$386 million. Our actuary has proposed, and we agree, that a reasonable estimate of the gain which can be attributed to the pensioner account would be the mean of the proportion of total actuarial liabilities represented by liabilities for pensioners and survivors at December 31, 1981 and December 31, 1984. At the end of 1981 the pensioner share of total liabilities was 39.89%. At the end of 1984, the pensioner share was 44.53%. The mean of those two percentages,

42.21%, applied to \$386 million is \$162.9 million. While mortality experience among pensioners was better than expected, our actuary has concluded that this produced not more than an \$11 million loss, giving an experience gain of \$151.9 million for 3 years, or \$50.6 million per year. The average actuarial cost of the ad hoc adjustments granted by CN for those years was \$32.2 million. The cost of the 1985 and 1986 adjustments is estimated at \$26.4 million each.

- 4-10 In allocating the unfunded liability to the pensioners, our actuary has suggested that since the amount attributable to the prior ad hocs is identifiable, it should be allocated to them. This means that the pensioners' unfunded portion — all other things being equal — will decline faster than the actives since the amortization period is shorter. It also means that the present mortality table and interest rate assumptions are frozen, at least for the pensioners' fund.

Unequal Distribution of the Experience Gain

- 4-11 The Sub-committee has recommended that adjustments to pensioners based on experience gains be greater for those retiring before 1976. Some would argue that this turns the Pension Fund into a welfare fund. We do not think this is the case. To return to a point which has been made several times, the recommendation that a certain portion of the experience surplus be allocated to pensioners does not mean that pensioners would own the surplus in the ordinary sense. No pensioner would have a claim on the surplus equal to that they would have on a savings account, for example. As a result we see no reason to divide the surplus according to, say, the earnings of each pensioner, or evenly among pensioners. There is every reason to divide the amount unevenly. For the most part, those who retired before 1976 did the same work and worked as hard and as faithfully for CN as those who came after them. Most of them did not receive the full benefits of wage increases, which were driven mainly by inflation. Many of them receive little benefit from the C/QPP. None of them benefits from the changes in 1973 and 1975. In this respect we approve of CN's past policy regarding pension adjustments, and we have adopted a similar approach.

Specific Proposals for the Allocation of Experience Gains

- 4-12 The Sub-committee has considered three approaches to the distribution of experience gains. The first would be to index pensions to the consumer price index (CPI), either fully or by some percentage, as proposed by the National Council. We have determined that the costs of such a scheme far exceed amounts which are likely to be available to the pensioner fund as experience gains.
- 4-13 The second approach would be to continue CN's current practice. This is to promise that pensions will be increased for life by amounts which vary downward according to the year of retirement. The problem with this approach is that the adjustment will be small relative to its actuarial value, and its cost, because it is promised for life. For example, the largest monthly adjustment in 1984, was \$31.50, the smallest \$14.00, but the actuarial value for all adjustments was \$45.7 million. This almost equals the amount available to pensioners as surplus on the basis of the 1984

valuation. Also, it must be remembered that CN does not grant increases to those retiring within ten years of the adjustment date. To be consistent with the Subcommittee's principle of giving something to pensioners regardless of when they retired, the adjustments resulting from the Subcommittee's recommendations on this basis would be even smaller than those CN gave in 1984.

4-14 A third approach would be to distribute all the money available for pensioners immediately without keeping any substantial amount in reserve for future payments. One possible distribution which meets the Subcommittee's criteria is the following. Assume that the scheme starts in 1987, rather than 1988, on the basis of an experience gain of \$50 million per year. All pensioners over age 65 and survivors over age 60 would receive an adjustment designed to offset some of the effect of current inflation. For example, all pensioners could be given an increase equal to 50% of the 1986 inflation rate. (In 1985 the inflation rate was 4%, 50% of that is 2%.) This amount would be subject to a ceiling or "cap". This measure would cost about \$5.5 million, and \$44.5 million (\$50 — 5.5 million) would be available for other purposes. In addition, everyone would receive a variable adjustment based on their pension benefit and the number of years they had been retired: for example, 2% of their 1985 CN pension multiplied by the number of years of retirement before 1967, graduating down to 1% for years after 1975. These adjustments would be subject to certain further restrictions, such as a cap based on 50% of YMPE. Survivors would count years of their spouses' retirement as their own. Where benefits are integrated with OAS, the supplements could be calculated on the benefit increased by the amount subtracted in respect of the OAS payment. In the second year of the scheme the adjustment for current inflation would be based on the previous 2 years' inflation rate. (Assuming inflation is also 4% in 1987, the 1988 increase would be 50% of 8%, which is 4%.) This would cost about \$11 million, so that \$39 million (\$50 — \$11) would be available for the percentage increases. And so on. A more detailed account of this scheme is presented in Appendix B of this Report.

4-15 The merits of the scheme are obvious. The greatest amount possible goes out to pensioners immediately. Part of the adjustment is designed to counteract the effects of current inflation. Provision is also made for those whose pensions have been affected the most in the past by inflation and other causes. This includes pensioners who made a choice to receive a pension integrated with OAS.

4-16 The scheme has its problems, however. Pensioners want some contractual CPI indexation partly because this provides some measure of certainty about their future purchasing power. The proposed scheme provides very little certainty. The amount of adjustment depends on the amount of experience surplus. There is no guarantee that any adjustment will continue for any extended period.

4-17 We have tested the scheme in Appendix B against pensioner and survivor data provided by CN using a number of assumptions. Of necessity, the data provided was grouped into 5 year blocks and we have not been able to verify the impact of the caps we imposed. Based on the limited tests we were able to perform, we believe that our scheme is reasonable and could work well into the XXI century. But the whole process depends on the emergence of an experience gain of a certain magnitude and this is not guaranteed; therefore the amount, or continuance, of the supplement cannot be

guaranteed. To cover these contingencies, the Trustees are given discretion to vary the formula, on the advice of the Pension Board sub-committee, in ways that seem appropriate at the time.

Pensioner Participation in Decisions about their Adjustments

4-18 The Sub-committee has put forward its detailed proposal for distributing experience gains as one of many possible proposals. The actual arrangement must be developed with the help of Plan actuaries. We believe that pensioners must have a say in formulating the arrangement. Since the adjustments are for their benefit, who else is better able to determine what their benefit is? Moreover, the process will be complicated. It is essential that pensioners ensure that it is fair and perceive it to be fair. In Chapter Six we set out a proposal for a new sub-committee of a revised pension Board which will be an important part of this process. However, we also propose that ultimate responsibility for accepting an arrangement, or for deciding that another would be more prudent given the state of the Fund, lies with the trustee. In the same chapter we recommend that independent trustees be appointed to ensure that their decisions are seen to be fair.

4-19 The Sub-committee's recommendations are similar in some respects and importantly different in others to a proposal presented to us by CREPA's actuarial adviser, The Wyatt Company, as a solution to pensioner problems. As we understand it, their proposal would involve the creation of a fund for all pensioners, current and future. The fund would not be a notional one, but would be in fact separate from the fund for actives, with a different somewhat more cautious investment policy. The goal of the fund would be to provide a supplement to all pensions-in-pay to offset the effects of inflation through the generation of experience surpluses. In order to ensure adjustments which would fully offset increases in the CPI — as far as this is possible — they suggest that the interest rate assumption on the fund be fixed at 4%. However, the assumption could be set at a higher figure if it were decided that smaller adjustments were acceptable. In the event of experience losses in the fund, which are considered unlikely, pension payments would be reduced. To provide against such an event, the proposal contemplates the creation of contingency reserves, which means that a part of the experience surplus ascribed to any period would not be paid out in adjustments but would be set aside to provide for possible future losses. The proposal does not contemplate any part of the unfunded liability being allotted to existing pensioners.

4-20 CREPA's advisers acknowledge that their solution is not equivalent to a promised degree of CPI indexation. Given interest rate returns of the past 20 years, setting the interest rate assumption at 4% would seem to guarantee some experience gains in the fund and significant adjustments each year. But it is admitted that experience gains will not necessarily match inflation rates over any specific period of time. For this reason, and because it would be necessary to set up reserves for experience losses, adjustments could not be guaranteed to match CPI increases for any particular year: in some years they might be greater, in some years less.

4-21 The Sub-committee has not adopted this proposal for two reasons. The first has to do with the specific suggestion that the pension fund interest rate be set at 4 or 5%.

The CN Plan was not designed and funded to provide for pensioner adjustments in this way. If the proposal were implemented now, payments for actives would have to increase. The unfunded liability would increase to account for payments to current pensioners and the actives' past service. We estimate that the increase in the unfunded liability would be in excess of \$1 billion and that current service costs would rise by at least 25%. We do not feel we can impose costs of such magnitude on CN. (If one replies that these costs will eventually be borne by active employees, we also do not feel that we can unilaterally impose such costs on them.)

4-22 CREPA's advisers have argued that in its failure to provide for pensioners CN has broken faith with them: because CN has a unique position in Canada's history, because the government of Canada has acknowledged the need to adjust pensions for those who work for them, CN should have done no less. They conclude that the cost of making things right in this case should not be a consideration in determining what must be done. We cannot agree with this position. With hindsight perhaps one can say that, at some point in the history of the Plan, it was unwise or wrong to proceed with amendments to the benefit formula, with other improvements or with buy backs rather than to redesign the plan to provide some measure of inflation protection. We do not think that this failure amounts to breaking faith with pensioners, or justifies the unilateral imposition of the costs of CREPA's proposal on CN now.

4-23 The second reason the Sub-committee has not adopted CREPA's proposal is that we wanted to separate the issue of what should be done for present pensioners from the issue of inflation protection for future pensioners. CREPA's actuaries have characterized the issues before us as a unique problem to which they offer a unique solution. For them the uniqueness seems to lie primarily in CN's failure to provide inflation protection for pensioners, while attempting to protect the value of the benefit for actives by raising wages and improving the benefit formula. We do not find these actions unique at all, which is not to say that we approve of them, but these are actions of the past. For this Sub-committee what is important about the situation of current CN pensioners is their history. Many pensioners have been with CN throughout their working lives. To paraphrase Dr. Noel Hall, they have experienced the hardships of the Depression while working at CN, they have in other ways suffered in long and faithful service to an industry which has been fundamental to the development and advancement of Canada's well-being. Despite this, CN pensioners have not reaped the full benefits of CN's pension plan in its present form, and they have borne the brunt of very high inflation rates, which the Plan does not protect against at all. For these reasons we have concluded that adjustments for these pensioners have been inadequate and that changes must be made immediately. We have tried to find an equitable way of producing larger adjustments without imposing too great a cost on CN.

4-24 As for the future, the Sub-committee is convinced that if inflation protection is not introduced into the CN Plan, future Parliaments will be faced with having to devote yet another set of hearings to the inadequacy of the Plan. We would prefer to see CN and the railway unions address this problem rather than present any particular plan of our own. We are not convinced that adjustments based on excess interest are better than CPI indexation, but we may be wrong. Also, ideally it should not be up to a third party to decide the extent of inflation protection for future CN pensioners. Different schemes will have different costs, which may be borne in

different ways: in the short run at least partly by CN, and by actives through a reduction in wages or other benefits, or even a reduction in the pension benefit formula.

4-25 We recognize that leaving the matter to the negotiating process has its disadvantages. CN has insisted, reasonably enough, that all unions adopt the same pension plan. From the evidence we have received, however, some unions seem more eager to bargain for inflation protection than others. Also it is clear from representations to us that younger employees are more interested in job security, higher wages and benefits which they can profit from today than benefits deferred to a time which to them has no reality. We understand this attitude, but we cannot allow it to persist. **We have heard from too many pensioners who have admitted that they became concerned about the adequacy of their pensions just before or after they reached retirement. At that point concern is fruitless.** We are prepared to leave the issue of inflation protection for current employees to CN and the unions. But we expect them to act. If they do not, we recommend that Parliament address the issue of mandating some form of inflation protection in the CN Plan. We would specify that both CN and the actives bear a fair share of the costs.

4-26 4.2 The Sub-committee recommends:

- (a) **that a measure of inflation protection be a priority item at the next round of contract negotiations between CN and the railway unions, and that the matter be bargained with a serious intent to reach a solution;**
- (b) **if the parties fail to reach a solution or if a solution fails to provide a reasonable measure of inflation protection, the government itself should introduce legislation providing a reasonable measure of inflation protection in the CN Plan, the cost to be borne fairly by CN and its employees.**

CHAPTER FIVE

Survivor Benefits

- 5-1 That a couple can live on a certain pension does not mean that a surviving spouse can live on half that pension. A number of significant expenses may not be reduced when a pensioner has died. We have heard eloquent testimony that the current 50% survivor benefit is too low. In Chapter Four we have made recommendations which would increase pensioners' and survivors' benefits. In addition we propose that the basic spousal benefit be increased to 60% of the pensioners benefit. In Appendix B we describe in detail how this proposal is to be implemented. With respect to the survivors of active employees we note that proposed pension benefits legislation will require all plans under federal jurisdiction, and this includes the CN Plan, to offer a 60% survivor benefit. We trust that this will be adequate.
- 5-2 **5.1 The Sub-committee recommends that current survivors and survivors of pensioners currently in the Plan as of January 1, 1987 receive a benefit which is equal to 60% of the original benefit (together with whatever adjustments have been made to the benefit in the past). This should be in addition to the recommendations made for current pensioners and survivors in Chapter Four; the increased survivor benefit would form the base on which to determine the Chapter Four calculations.**
- 5-3 Our actuary has estimated that the increase of the survivor benefit alone would cost about \$114 million, or \$12.5 million per year assuming an amortization period of 15 years. We feel that CN is able to absorb this cost.
- 5-4 **5.2 The Sub-committee recommends:**
- (a) **that those who marry Plan members immediately before or sometime after retirement be eligible for survivor benefits;**

(b) and that the benefits of survivors not be reduced because of the age difference between themselves and the plan member.

5-5 We feel that the present provisions regarding survivors are discriminatory: they penalize certain decisions to marry, and one penalizes a spouse for being a certain age. We do not feel that members and their spouses should be affected in this way. We point out that in its Report of October 1985 the Sub-Committee on Equality Rights of the House of Commons Standing Committee on Justice and Legal Affairs found similar provisions of the Public Service Superannuation Act to be contrary to section 15 of the Charter of Rights. Whether or not the same arguments could be made with respect to the pension plans of Crown corporations, which are not normally incorporated into legislation, we feel that it is in the spirit of equality to make the recommendations that we do.

CHAPTER SIX

Eliminating Mistrust — Pension Board and Trusteeship

... also I want to know how much money the CN officials including the presidents got for being on the pension board. I also want to know where the CN got the right to pack the pension board with some 17 CN official leeches, as against a minority of 3 or 4 union officials and one or two pensioners who are not actuaries or accountants and know very little about balance sheets, and should not the board of such importance to the lives of so many citizens not be a preponderance of independents such as educators, independent accountants and or clergy and *decent* citizens for a change, because the money does not belong to CN for conversion ... (Excerpt from brief submitted to the Sub-committee by Mr. Ivan Sprague, Toronto, Ontario.)

Pension funds are power weapons in the modern business world and can be manipulated by companies and individuals. Chief executives will fight to the death to maintain control of these huge funds. The only way CN pensioners can expect to receive pensions that our fund can afford to pay is to have these funds removed from control of the CN management; a separate trust company should be set up to only handle this fund with the objectives of investing and managing the fund, to pay fair pensions that the fund is able to pay with the monies available. This should be done before the demise of the present pensioners who have suffered from inflation and received no benefits from it. (Excerpt from brief submitted to the Sub-committee by Mr. Leslie S.G. Moore, Sidney, British Columbia.)

- 6-1 The issues of indexation and pensioner claims on the Pension Fund are not the only ones arising out of the briefs and oral testimony the Sub-committee has received. We think it is equally important to address the mistrust and suspicion directed at CN management which has developed over the years. We were struck by the bitterness and disappointment of many pensioners, an emotion made more intense by their loyalty and affection to their work with the railroad.
- 6-2 We find that CN is responsible for much of the ill-will which exists between pensioners and the company. CN has insisted on continuing to be trustee of the Pension Fund, contrary to the popular recommendation of Dr. Noel Hall, although it would have been of no consequence to CN to operate the Plan with independent trustees. CN has paid little attention to working out ways which would give pensioners a voice in matters which concern them. Until this Sub-committee was struck, CN has made little effort to give pensioners and active employees information about their Plan which they can understand. We discuss the issues regarding administration in this chapter, and the problem of communication and disclosure of information in the next.

The Pension Board

- 6-3 The Pension Board has been a source of frustration for many pensioners. The Board is dominated by representatives of CN and active employees. Some pensioners find that present rules regarding pensioner representation are inadequate. What is most important, the Board as a whole has little power: it must approve benefits as determined by the Plan, and its decisions are subject to the approval of the trustee.
- 6-4 The Sub-committee does not think that a radical restructuring of the Pension Board is appropriate. However our recommendations in Chapter Four require significant pensioner participation in the development of arrangements for the adjustment of pensioner benefits. We propose that the composition of the Pension Board be changed to accommodate this new role for pensioners. We emphasize that this new power would not be absolute: the arrangements would be determined by our recommendations, which would in turn be incorporated into the Plan, and they would be subject to the discretion of the trustees.
- 6-5 The new Pension Board should be made up of 15 members, 5 each representing management and the unions, and 5 pensioners. The criteria for union and management representation should be the same as now exists with one exception; middle management employees are not now represented as a group on the Board and we propose that this be done. One way of ensuring fair representation of pensioners and survivors would be to invite nominations and carry out balloting by mail. CN is in touch with all its pensioners each month when it sends out pension cheques. There are 5 regional divisions of CN, and each could be allotted a representative.
- 6-6 Decisions about pensioner adjustments would be made by a sub-committee of the new Board made up of the 5 pensioners and 5 CN representatives. Each member of the Board would be given all the actuarial information required to make informed decisions, and all the help necessary to interpret this information.

6-7 We also feel that the expanded Pension Board should be given an important function which it does not now have. At present, there is no way for a retiring employee or a pensioner to appeal a decision of the Pension Board with respect to the interpretation of the Plan and the resulting Plan benefit without going to court. We have in mind the particular case of a witness who was denied pension credits for certain war years on the grounds that he had terminated his service with CN. At issue was whether the evidence really did support the conclusion that the employee had left the Company. We feel that the Plan should provide a simple administrative solution to this problem rather than forcing a plan member to go through the formality, delay and expense of a legal solution. We propose that the full Pension Board be required to reconsider its own decisions at the request of anyone eligible for a benefit.

6-8 Although we think that in general not too much time should elapse between the awarding of the benefit and the review process, we feel that the grievances of current pensioners are an exception. We propose that all current pensioners be allowed to take advantage of the review procedure, and that in their case only, where evidence supplied by the pensioner will refer to events long past, that a special and favourable weight should be attached to that evidence.

6-9 Decisions of the Pension Board are now subject to the approval of the trustee. In addition to our other recommendations regarding the trusteeship, we propose that trustees be given the express power to review the decisions of the Pension Board.

6-10 The Sub-committee also notes that the National Council has testified that the present Board has been useful in cutting through red tape and removing other irritants. We would hope that the new Board would be more effective in identifying pensioner concerns and proposing acceptable solutions.

Trusteeship

6-11 CN established the administrative structure of the 1935 and 1959 Plans without consultation with its employees. It has always been the trustee of the Pension Plan funds. Changes in the trusteeship arrangements or other administrative changes have never been subject of union-management negotiations.

6-12 CN has been criticized by Dr. Noel Hall and, supporting and following him, CN employees and pensioners, for continuing to hold the trusteeship function. The Sub-committee's legal adviser has also concluded that CN's trusteeship arrangements violate both the letter and the spirit of the present *Pension Benefits Standards Act*. We should point out, however, that in 1978 the Superintendent of Insurance appears to have received a contrary opinion from the Department of Justice.

6-13 **A number of our witnesses believe that trustee arrangements should be changed because an independent trustee would provide better pensions. This is not the case.** As we have explained, and our legal adviser has confirmed, trustees must act in accordance with the trust instrument, the law of trusts, and any statutory requirements. They cannot be ordered by the Plan beneficiaries — pensioners or active employees — to do anything. Nor can trustees choose to make payments according to their own sense of fairness. In this case, the trust instrument is the CNR

Pension Plan itself. Under the Plan, CN as trustee can only withdraw amounts equal to benefit payments pursuant to the Plan, together with the costs of administering the Plan. CN as trustee will be able to pay out larger amounts for the benefit of pensioners only when the Plan is changed to allow it to do so. Those responsible for changing the Plan are CN and the railway unions.

6-14 **Although changes in the trustee arrangements will not increase pension benefits or cause CN to change its actions in any way at all, the Sub-committee feels that CN should not continue to be the trustee of the Plan. It is clear to us, as it was 10 years earlier to Dr. Hall, that a number of pensioners do not trust CN to manage Plan funds without regard to CN's own interest. They are wrong in fact. We have found that CN has managed the Fund effectively. (We emphasize that Dr. Hall came to the same conclusion.) We have found no evidence that CN as trustee has acted otherwise than on behalf of Plan beneficiaries, and we conclude that CN has been a responsible trustee. But the facts are not at issue here, and it is not on that basis that we recommend a change. Rather, we think it important to eliminate the perception that CN may be biased in its dealings with the Plan. To borrow the words of our legal adviser, we favour a "visibly detached and disinterested trusteeship" to which employees and pensioners can look for objectivity. We emphasize the word "visibly". We should point out that proposed federal pension benefits legislation would seem to permit CN's current arrangement, whatever its legality under present legislation. We would still conclude that the present arrangement be changed. We are critical of CN for not having done so some 10 years ago.**

6-15 We propose that there be 5 individual trustees appointed by Cabinet. Trustees would have the same powers that CN as trustee now has with regard to the collection of contributions, making of investments and determination of benefits. In particular, we approve of the practice of delegating the responsibility for investment policy and day-to-day decision-making to the Investment Committee and Investment Division. They have performed well in the past, and we propose that they continue. The trustees would of course retain the power of dismissing either group if it fails to act in the best interests of plan beneficiaries.

6-16 As an additional matter, we note that there has never been a deed of trust which sets out the responsibilities and powers of the trustees in detail and is separate from the provisions of the Pension Plan. We think that such a document should be drawn up. (Charts 6-1 and 6-2 illustrate the changes recommended.)

6-17 **6.1 The Sub-committee recommends that**

- (a) the Plan rules be changed to provide for a new Pension Board;**
- (b) the proposed Pension Board be composed of 5 representatives each from CN, unions, and pensioners;**
- (c) CN members include one representative from middle-management;**
- (d) there be one pensioner representative from each CN Regional Division, the representatives to be nominated and elected by mail;**
- (e) a sub-committee of the proposed Pension Board composed of CN and pensioner members be responsible for the distribution of the experience**

surplus attributed to pensioners as proposed in Recommendation 4-1; pensioners should be given all the information necessary in a form which they can understand to make proper decisions;

- (f) the full Pension Board should be required to reconsider its decisions regarding the interpretation of the Plan at the request of anyone eligible to receive a benefit;
- the request must be submitted within a reasonable period of time after the award is made;
 - the applicant must be given the opportunity to be heard.
- (g) current pensioners should be allowed to request a Pension Board review regardless of the time a decision about their benefit was made; in their case only, special and favourable weight should be attached to their evidence;
- (h) the full Pension Board should be given express powers to consider and propose solutions to pensioner concerns;
- (i) there should be 5 trustees of the CN Pension Plan appointed by Governor-in-Council;
- (j) the criteria for appointment should be the same as that for the appointment to the board of directors of any Crown corporation;
- (k) the trustees should retain the powers of the present trustee (the CN);
- (l) the trustees should be given the discretion to implement a distribution of the experience gain attributable to pensioners recommended by the Pension Board Sub-committee as proposed in Recommendation 4-1;
- (m) the trustees should be expressly given the power of review over decisions of the Pension Board regarding the interpretation of the Pension Plan;
- (n) CN should have a trust deed prepared for the Pension Plan.

CHART 6-1

RELATIONSHIP BETWEEN THE TRUSTEES THE PENSION BOARD AND CN - GENERAL

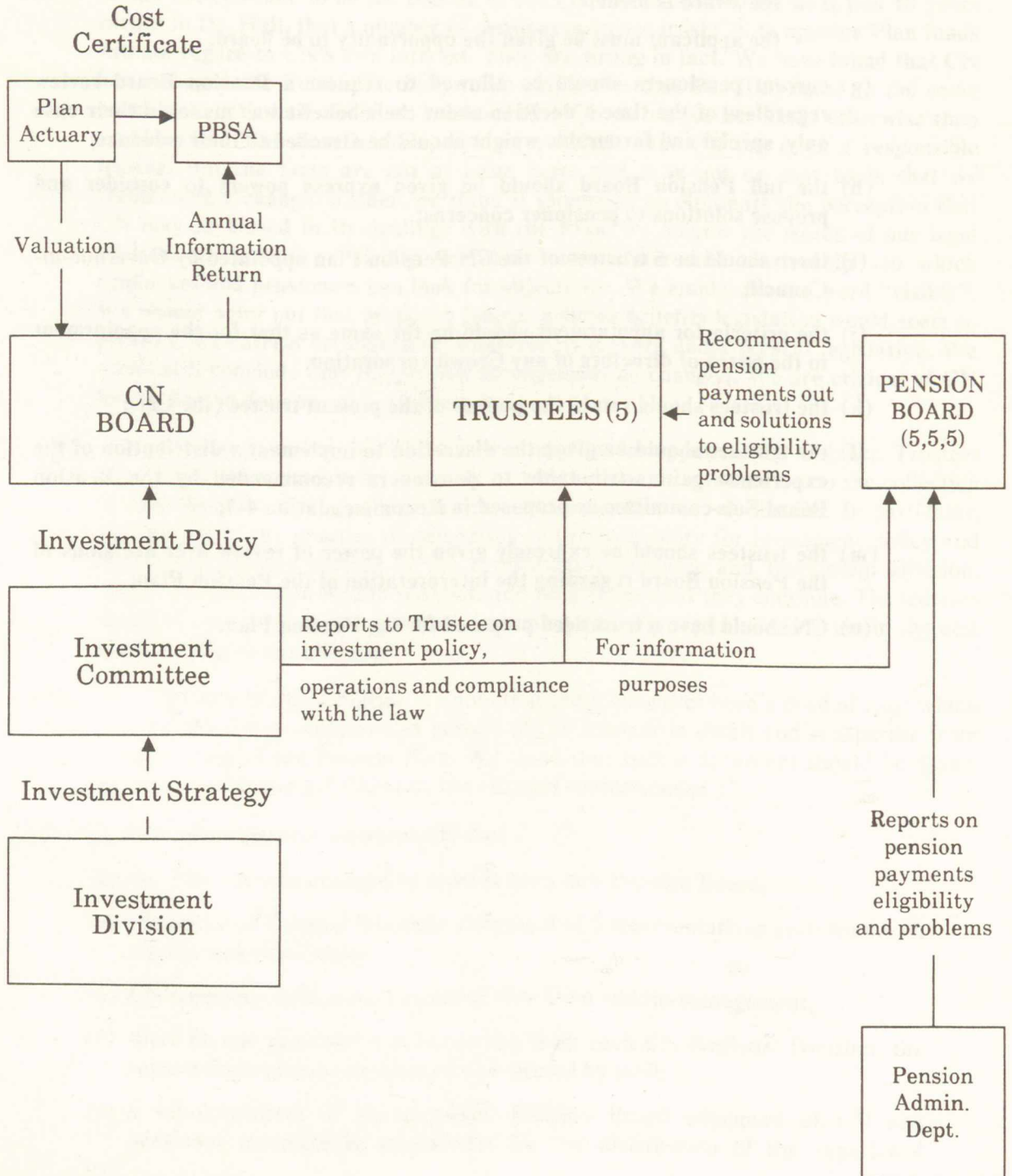
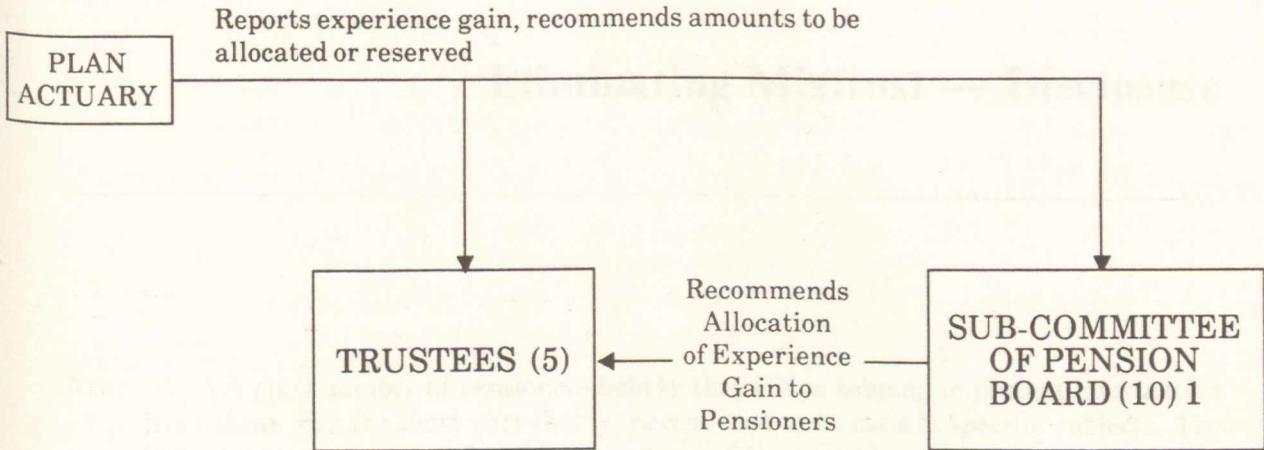


CHART 6-2

CHAPTER SEVEN

RELATIONSHIP BETWEEN THE TRUSTEES AND SUB-COMMITTEE OF THE PENSION BOARD - PENSIONER FUND ALLOCATION



CHAPTER SEVEN

Eliminating Mistrust — Disclosure

7-1 A good number of pensioners believe that CN is keeping important information from them. For the most part their concerns centre on certain specific subjects. The Sub-committee has already addressed some of them, such as the unfunded liability, and CN's supposed neglect in failing to match employee contributions to the Fund. Some we discuss in subsequent chapters of our Report: the consequences of accepting a benefit which "bridges" the date of retirement with the receipt of OAS; what it means to say that the CN benefit is "integrated" with the C/QPP; how amounts needed to pay for the buy-back of past service were calculated, and so on.

7-2 Through questioning we have found that most pensioners do not understand essential points about their Plan, and have misunderstood much of the information they have been given. We blame CN for much of this misunderstanding. We have received a representative sample of booklets, announcements, letters and forms issued by CN to pensioners and active employees over the years. The best one can say about them is that they have been written for the convenience of CN administrators. They show no understanding of what information pensioners need to know or how to express it in language they understand.

7-3 While we recognize that explanation will not necessarily resolve all differences between pensioners and CN, we do believe that more openness and a proper attempt to explain would reduce the mistrust and hostility of many pensioners.

7-4 During our hearings and investigations it has become evident that there is no group or individual at CN who is both responsible for the Plan and understands its workings in all its aspects. This may well be one of the reasons why CN's problems arose in the first place. We admit that there are probably very few employers in Canada who are experienced at assessing the effects of a plan on its members and on

their own image and financial position. Nevertheless, CN pensioners have appeared before the Standing Committee on Transport saying essentially the same things since 1970. It was only in December 1985 at the end of our own hearings that CN finally admitted that there were problems which it had to address.

7-5 In its December submission to the Sub-committee, CN indicated a number of initiatives it had recently undertaken, including the hiring of a communications consultant. We encourage their efforts and urge speedy progress. We do not hold ourselves out to be communications specialists, nevertheless we would single out two areas which seem to need immediate attention: the training of pension and regional employee relations personnel to ensure that they fully understand the Plan, and the improvement of pre-retirement counselling to ensure that employees understand what options they have and how each option might affect them.

7-6 We note that proposed pension benefits standards legislation has new provisions regarding disclosure of information to active employees. We feel that in the case of CN plan members the employer should be required to do more. As a result of the controversy over the CN Fund and the funding process, CN pensioners are very much interested in knowing how funds are invested, how favourable or unfavourable investment and other experience has been and how CN's yearly contributions are determined. Also, as a result of our recommendations regarding the notional splitting of the fund, such information must be available to some pensioners at least.

7-7 CN's Investment Division has always regarded its annual Investment Report as confidential. We see no reason for this. We do not believe that disclosure, after the fact, will harm CN's investment operations. We feel that the secrecy surrounding the Fund's investment has only resulted in false rumours and general — and unfounded — suspicion of incompetency. We conclude that information on investment and funding should be made available to all pensioners in a form which they can easily understand. This could be done annually in an edition of "Keeping Track", the CN company magazine distributed to employees and pensioners.

7-8 With respect to active employees, CN should be prepared to disclose all the information necessary to prevent misunderstanding of the sort that exists today. Members and their spouses should have a good understanding of the benefits available to them under various conditions, such as termination, disability and retirement. Proposed pension benefits legislation will affect CN's vesting and portability rules but only with respect to years of service after January 1, 1987. Members and spouses should understand how amounts owing to them before and after that date will be calculated should they leave before retirement. Members should also know how much they have contributed to the Plan and what interest rates have been ascribed to these amounts for purposes of portability. They should be able to correct any errors with regard to any personal information CN will use to determine their benefits.

7-9 **7.1 The Sub-committee recommends that in addition to or as complementary to the provisions of Bill C-90, the proposed *Pension Benefits Standards Act*, as introduced in December, 1985**

(a) CN provide all pensioners with the following:

(i) a summary of the information contained in the annual Report of the Investment Division;

- (ii) a summary of information and recommendations concerning funding contained in each actuarial valuation.

This information should be presented intelligibly in "Keeping Track", or in some other similar way.

(b) CN provide all active employees with the following:

- (i) the information described in paragraphs a)(i) and a)(ii) above;
- (ii) financial data including,
- cumulative contributions and interest to previous year
 - member contributions for current year
 - interest credited for current year
 - cumulative contributions and interest to current year
 - the rate of interest being credited as at year-end;
- (iii) personal data including,
- date of birth
 - date of entry into plan
 - pensionable service accrued to date
 - date of normal retirement
 - declaration designating a spouse as the survivor and any other relevant declarations regarding the survivor benefit;
- (iv) general data including,
- an explanation of how the benefit will be calculated
 - the effect of C/QPP integration
 - how the vesting rules apply to the member years of service.

7-10 With respect to disclosing accounting information at least, CN is a leader. The CN Annual Report contains two sets of financial statements. The Consolidated Financial Statement of the CNR System, footnote 8, conforms substantially with the Canadian Institute of Chartered Accountants (CICA) *Handbook* standards for reporting on pension plans in financial statements (section 3460). In this respect CN provides greater disclosure than most other Canadian companies according to the CICA's own compliance review of 1983.

7-11 The Annual Report also contains the Pension Trust Fund Consolidated Statement of Financial Position and has done so since 1960. This statement contains an Auditor's Report and an Actuarial Certificate concerning the pension liability. In this area of reporting, we believe CN is unique among Canadian companies. The financial presentation follows closely the recommendations of a 1984 CICA Research Study. A portion of the statement is reproduced annually in "Keeping Track" as part of the Pension Board report.

7-12 Despite this high level of disclosure, there remains a fundamental problem. The two sets of statements are prepared for different purposes, and it is impossible for an informed person to reconcile the information in one with that in the other. Access to

the actuarial valuation reports will not improve the situation. The reason for this is that accountants in preparing the CNR System financial statements are concerned with allocating only those amounts in respect of a certain year which they consider to be expenses incurred in that year. Actuaries are concerned with establishing a consistent funding pattern and recommend an allocation of amounts on that basis. In any year these two amounts will probably differ.

7-13 When preparing the Pension Trust Fund financial statement — as opposed to CN's — accountants will come closer to following the actuarial funding pattern. Even here there can be differences as the accountant's objective is to help plan members assess the security of the pension benefit.

7-14 The result is that the accountants may present two financial statements and the actuary a third, all claiming to report on the same subject. Having observed the problems arising from CN's level of disclosure, we are concerned at the potential for greater misunderstanding. Is it possible for these apparent inconsistencies to be reconciled in the light of the necessity for greater disclosure and understanding?

7-15 We understand that a similar problem arose in the life insurance industry as accountants and actuaries began to disagree on presentation. The Department of Insurance resolved the issue by prescribing the format and contents of financial statements which would be acceptable for its purposes. This has created a reasonable degree of uniformity in reporting and statements produced for other purposes can show a reconciliation.

7-16 **7.2 The Sub-committee recommends that the Superintendant of Insurance consider the possibility of prescribing for the purposes of pension benefits legislation the set of financial statements to be issued.**

CHAPTER EIGHT

Integration: An Example of Failure to Communicate

8-1 Two complaints prominent in the submissions to the Sub-committee relate to misunderstandings concerning:

(1) the integration of the CN pension with the Canada/Quebec Pension Plans (C/QPP), particularly by those who opted to retire prior to 65.

and (2) the optional "bridging" or integration of the CN pension with Old Age Security (OAS) for individuals who retire before 65.

8-2 We feel that these particular misunderstandings are prime examples of CN's failure to communicate. In the past, information about these plan features was provided by stilted form letters with references to Plan rules written in legal jargon. The forms appear to have been designed to ease the work of administrators who understand the plan thoroughly. All too often their real function, which was to explain things to the pensioner, was forgotten.

8-3 CN's Plan allows an employee who has worked for 35 years to retire at age 60 with a full pension and an employee who has worked for 30 years to retire at age 55 with a reduced pension. Because of CN's practice in the 1940's of hiring very young employees, in recent years many employees have completed 30 to 35 years of service and have chosen to retire before age 65. However, OAS and CPP benefits only begin to be paid out at age 65. These retirees are not immediately eligible for these benefits.

C/QPP Integration

8-4 As is the case with most defined benefit pension plans the CN pension is integrated with C/QPP, and has been since 1967. The integrated plan is designed to

produce a total pension equal to at least 70% of the final five year average salary at age 65. This level of pension was considered by the Task Force on Pension Reform to be an acceptable level of benefit. In fact, at age 65, the CN pension together with C/QPP and OAS, and taking into account certain tax benefits, can produce post-retirement after-tax income equal to, or even greater than, pre-retirement after-tax income for individuals earning up to the AIW in 1985 of about \$25,000.

- 8-5 The plan members' problem with respect to CPP integration is a failure to understand that the CN Pension is not a 70% benefit itself, but the integrated benefit is. Appreciating this is particularly important for early retirees because part of their total pension — CPP — does not begin until age 65.
- 8-6 This misunderstanding has been compounded by one of CN's pension estimate forms, which has since been revised. For ease of calculation the form shows the C/QPP benefit as a deduction in calculating the CN pension. As a result many employees and pensioners have come to believe that the C/QPP benefit is a deduction from their pension — a penalty. In fact, it is an addition. It must be seen as forming part of the guarantee that the retirement pension will equal 70% of a pensioner's earnings after working for 35 years. As a matter of fact, one specific pension estimate the Sub-committee has reviewed shows that had the employee retired in 1985 at 65 he would have received a CN and C/QPP benefit equal to 74% of his earnings. The CN benefit alone would have constituted 63% of his earnings. However, in order to realize this we had to do some calculations. The information should have been there for the employee to see.
- 8-7 It is true that it is inherent in the design of the integrated plan that for many CN employees an increasing percentage of the benefit will be provided by C/QPP. In 2002, 20-25% will come from the public plans and 50-45% from CN. In our opinion this fact must have been recognized by unions, since it was discussed and the benefit to CN calculated by Professor Deutsch in his 1973 Report on the agreement on increased pension benefits reached by the railroad unions and companies in that year.
- 8-8 Employees who are thinking about retiring before age 65 must understand that their retirement benefit has an age-related component. The responsibility for pointing this out, and for urging the employee to consider the consequences in the light of their own financial positions, lies with CN.

OAS Bridging

- 8-9 Many occupational plans offer early retirees a benefit bridging the gap between the time they retire and age 65. It is our impression that it is the CPP benefit which is most often bridged. However, CN offers bridging against OAS and has done so since 1968.
- 8-10 The advantage for early retirees is obvious. They receive a relatively level stream of income before and after age 65, and higher amounts before age 65 than they otherwise would have. This makes retirement planning easier. The disadvantages appear much later. **Amounts equal to the OAS benefit received by the pensioner on retirement are deducted from the pension benefit for the rest of the pensioner's life, starting at age 65.**

- 8-11 The problem arises with pensioners who chose to bridge and believed that the benefit was a loan, which on their calculations would have been paid up by the time they reached, say, age 72. They do not understand why CN continues to deduct amounts after that time.
- 8-12 In fact a bridging benefit is not a loan. It is designed on an actuarial basis in the following way. Suppose the employee is about to retire now in 1986 at age 55. First, CN determines how much OAS the employee would likely receive after turning 65 in 10 years from now. This calculation will depend on an assumption about the number of years the employee is likely to live after age 65, which in turn is determined by standard mortality tables. Then CN determines how much it would cost now to buy an annuity which would generate those OAS payments beginning at age 65; that is, CN determines the "present value" of the expected payments. CN uses that amount to determine the stream of payments it can generate for the 10 years between 1986 and 1996, when the pensioner becomes age 65. Those payments are the bridging benefit.
- 8-13 In other words, CN pays the equivalent of the expected OAS payments to retiring employees "up front". Employees contract to amortize the pay-back over the period between age 65 and death. To put the matter bluntly, if pensioners live longer than the mortality assumption used in the calculations, the result favours the CN, if not, the result favours the pensioner.
- 8-14 Pensioners have claimed they were not told that deductions were to be made for the rest of their lives. Some have alleged that they were forced to take the bridging benefit. We do not have the information to judge the validity of their claims. However, it should be pointed out that one pensioner sent the Sub-committee a copy of an article from "Keeping Track", printed in January 1968 when OAS bridging was introduced. The article makes it fairly clear that deductions were to be made for the rest of the pensioner's life.
- 8-15 At any rate, it is clear that CN must do all it can to explain the consequences of the bridging benefit to its employees.

CHAPTER NINE

INVESTMENTS

- 9-1 The CN Pension Trust Fund at \$3.7 billion is a very large pool of Canadian invested assets. One of the largest private sector funds, it is equal to or greater than the Canadian assets of many domestic life insurance companies. As such, its operations and performance are worthy of attention. The general lack of comment by witnesses, and the difference in the few remarks which were made, was surprising.
- 9-2 **While both the CN National Council of CN Pensioners and CREPA were complimentary towards the CN Investment Division in varying degrees, the testimony of others again revealed the mistrust that pervades the relationship between the employees, pensioners and CN. This is a recurring theme in our review of the CN Pension System, and we cannot stress too often that this is the fault of CN management. We heard accusations, generally qualified by the acknowledgement that no firm evidence was available, that the pension trust funds were being used to further CN's own financial interests. This was done directly, it was alleged, by investing in CN related projects or indirectly by lending money to CN at favourable rates. In addition, the competency of the Investment Division was questioned. The Subcommittee concludes that these accusations are without foundation. They are based on assumptions and rumours which arise from a lack of information.**
- 9-3 A separate group, the CN Investment Division, manages the investments of the Pension Trust Fund. This Division is created by Board of CN (as Trustee) and reports to the Board. It operates in a similiar way to an independent investment counselling firm. To assist and advise the Division, the Board has created an Investment Committee. This Committee is currently comprised of 4 members of the Board and 4 CN management officers, including the President of CN's Investment Division. Meeting monthly, the Committee reviews, advises and concurs in the investment policy and the rules and regulations for management of the Division. The Committee

establishes guidelines for directing the investments and approves specific investments as evidenced by the minutes. The Investment Division reports to the CN Board (as Trustee) and reviews its operations with the Pension Board each year.

9-4 We have met with the Investment Division and reviewed its portfolio and operating procedures. We would characterize the portfolio and operations as conservative in structure and management. All the appropriate rules and controls are in place and effective. The asset mix or distribution of the portfolio is typical for a fund of this size and maturity. We note that there is a tendency to hold more equity ownership investments than the norm. This is best evidenced by the investments in oil and gas and real estate. These are specialized investments which only a fund of this size can undertake, given the expenditure and level of expertise required. We feel they are appropriate.

9-5 With respect to one of the specific accusations, it is the written policy of CN Investment Division "not [to invest] in securities or debt instruments of Canadian National Railways". The accusers fail to appreciate the legal responsibility imposed on trustees, in this case the Board of Directors, with respect to any potential conflict of interest.

9-6 Every year the Investment Division prepares an investment report for the Board of Directors and the Pension Board which runs to 20 pages. We think it important to quote an excerpt from the 1984 Report:

Investment Policy since the second half of 1983 has marked a departure from previous years in that bonds have been temporarily favoured over equities because the guaranteed yields thereon have been more attractive. The 1984 fixed income strategy called for bond purchases of shorter maturity; this strategy was reversed in the second half of the year when it became imprudent to ignore the sustained improvement in inflation.

- The Fund will continue to purchase bonds with a term to maturity of approximately ten years
- Within the next twelve months, the fund anticipates a return to this long-term preference for equities ... foreign (equity) investments will therefore be kept at the legal maximum.
- Real estate activity will be concentrated on maximizing returns from the present portfolio ...
- Oil and gas activity will be directed towards exploration and development ...

9-7 Accompanying the Investment Policy statement is a table showing the actual and proposed distribution of Investments.

	Long Term	6-12 Months	31 December
FIXED INCOME			
Short Term	5%	1%	5%
Bonds and Mortgages			
Maturing within 8 years	20	27	27
Maturing after 8 years	19	26	22
	44%	54%	54%
EQUITY OWNERSHIP			
Equities—Canadian	35%	25%	25%
— Foreign	10	10	11
Private Corporations	1	1	1
Oil and Gas	5	5	4
Real Estate	5	5	5
	56%	46%	46%

9-8 In subsequent pages each of the investment classes is reviewed in some detail.

9-9 We have already made a recommendation with respect to the disclosure of information contained in the Investment Report.

9-10 We have received an analysis of the investment performance of the Fund conducted by an independent performance measurement firm. From it, we conclude that performance of the CN Investment Division, as compared with other pension fund managers and against general market indices, has been very acceptable and in certain categories superior. We see no reason why there should be any change made in the investment management of the Fund.

CHAPTER TEN

Additional Subjects

- 10-1 As we have pointed out above, pensioners had a number of specific and important concerns which were not directly related to the major theme of benefit adjustments. We discuss a number of them in this chapter.

Intercolonial and Prince Edward Island Railways Employees' Provident Fund

- 10-2 Strictly speaking, the Intercolonial and Prince Edward Island Railways Employees' Provident Fund is not part of the CN pension system. The Fund was established in 1907 by an Act of Parliament which is still in force and which sets out Fund benefits. The Fund became insolvent in 1923 and to this day has been dependent on regular Parliamentary appropriations for the payment of benefits. The Fund was closed to new members in 1929. While CN has no control over Fund benefits it does administer its provisions: it draws pension cheques out of its own funds (not the CN Pension Fund) and charges the Minister of Transport for amounts paid out and for administration.
- 10-3 All employees of the PEI Railway, whether Fund members or not, have been given the same opportunities to join CN's 1959 Plan as those given to members of CN's 1935 Plan. However, for various reasons — a witness has suggested that Provident Fund members were badly informed and confused about the cost and benefits of joining the 1959 Plan — many did not join. In December 1985 there were 511 members of the Provident Fund. We were surprised to learn that the Fund makes no provision for survivors at all.

10-4 **10.1 The Sub-committee recommends that**

- (a) **the Minister of Transport introduce legislation to include a 60% survivor benefit retroactively into the arrangements of the Provident Fund, and to adjust Fund benefits as set out in our Recommendations 4-1 and 5-1;**
- (b) **the government fully fund these improvements;**
- (c) **the trustees of CN hold the funds and administer the Fund arrangements separately from the CN Plan on behalf of the Minister of Transport.**

Private Health Care Insurance Coverage for CN Pensioners

10-5 A number of groups who appeared before the Sub-Committee raised an issue which is closely connected with their concern regarding the CN pension Plan although it is not a pension issue; that is, CN's actions with respect to extended health care insurance for pensioners.

10-6 Until 1983, CN provided optional health care coverage for pensioners and actives at their own expense with Blue Cross as carrier. Before 1977, there were five different plans. Members in B.C., Saskatchewan, Alberta and the Northwest Territories were under one plan, as were those in Manitoba, Ontario, Quebec and the Atlantic Provinces. Premiums for the Manitoba and western plans were based on the experience of the whole group — pensioners and actives. The other plans distinguished between pensioners and actives and had a different rate for each. In 1976, a meeting was held by the National Council of CN Pensioners' Associations, the associated Non-Operating Unions and CN to discuss Blue Cross coverage. It was agreed that pensioners could be grouped with active members in Quebec as well as in Manitoba and the Western provinces. There was no such agreement with respect to those in plans in Ontario or the Atlantic provinces. The grouping of pensioners with actives lowered premiums for pensioners, whose health care needs were greater.

10-7 In 1982, railway labour negotiations carried out between CN, CP and the Associated Non-Operating unions made it necessary to change the 1976 arrangement. The unions agreed to a new health care package with another carrier. It provided universal coverage paid by the employer and covered active employees only. The plan was implemented in January 1983. With respect to pensioners, CN asked Blue Cross to cover all those who were no longer in a combined plan. For these pensioners, premiums were immediately increased. Pensioners in Ontario and the Atlantic provinces, however, were unaffected by the new arrangement. The National Council of CN Pensioners' Associations asked CN to provide options in Blue Cross coverage in order to allow pensioners to reduce premium costs. Three options were proposed with very different associated rates. For example, in Quebec the family rate for the lowest cost option (semi-private hospital room) is about \$19.00 per month. The rate for the most expensive option (semi-private room, extra health care benefits, drug costs) is about \$44.00 per month.

10-8 At present 27,000 of 47,000 pensioners are covered by Blue Cross plans. In 1984, premiums were raised for all plans except those covering members in the

Atlantic provinces. Seventeen months later, in August 1985, premiums were increased for all plans: 38% for the Atlantic provinces, 18% for Quebec, 19% for Ontario, 8% for Manitoba, 14% for the Western provinces.

10-9 The groups who have been concerned about this issue have raised a number of points. First, the cost of premiums is very high for some pensioners. As we have noted, the third option for Quebec pensioners costs about \$44 per month. Second, those pensioners who were part of a combined group have seen their premium rates raised considerably since 1983. (In the Quebec case — using the most costly option — the monthly premium rose from \$14.10 to \$43.65, an increase of over 200%.) Third, and equally important, pensioners feel that they should had had some voice in the 1983 arrangements, since they were adversely affected. Because pensioners feel their interests have been neglected, they are suspicious of the arrangements CN has made for them with Blue Cross, and wonder if something better could not have been done with another carrier. Finally, concerned pensioners want to be part of a process, or at least want their interests represented in a process, which would lead to their being incorporated into a plan together with active employees so that their premiums might be significantly reduced.

10-10 The Sub-committee does not have the mandate to give this issue the careful attention it deserves. More information is needed about the health care needs of pensioners in each group, whether public provincial health plans are in fact providing these needs, and to what extent the various options provided by the Blue Cross plans themselves meet them. Evidence before the Sub-committee suggests that some pensioners are not happy with the options they have been offered through Blue Cross and would prefer another arrangement. Also, not all pensioners enrolled in Blue Cross programs have been affected by premium increases in the same way. Those in the Quebec plan would appear to have received the steepest increases. This may result from a variety of factors: differences in the extent of coverage by provincial plans, differences in the make-up of the pensioners in each plan (for example the ratio of those over 65, who may receive more coverage under the provincial plan, to those under 65), and differences in the experience of the members in each plan. There may be various ways to resolve this issue.

10-11 **The Sub-committee wishes to comment generally on the matter of pension-related benefits. Over the years pensioners have been given or have won for themselves certain advantages from the railway companies — both CN and CP. It would appear, though, that when it is no longer convenient to benefit pensioners, decisions are taken which diminish or eliminate their benefits without consultation with them and without any real desire to make the protection of pensioner interests part of the decision making process. This seems to have been the case with respect to Blue Cross coverage. We have heard from a number of pensioners of the Canadian Pacific Railway who feel that this is true of the decision to take away their railway passes. We strongly disapprove of this attitude to pensioner interests. Whether they are legally protected or not, these interests are not expendable. Railways and unions must find ways to incorporate pensioner concerns fairly into the negotiating process. If this is not done, inevitably they will be forced to accept unwelcome decisions formulated by Parliament.**

Disability Benefit

10-12 The Sub-committee finds it unusual that the only disability benefit for unionized employees is the one provided by the pension Plan. While the Plan benefit may be adequate for long service employees, it is not so for those who have worked for shorter periods. Also, there is no benefit for employees who have worked less than 15 years. We note there are other arrangements regarding disability payments for non-unionized CN employees. **We conclude that CN and the railway unions should consider providing better disability benefits for unionized employees outside the pension plan.**

Earlier-than-Early Retirement

10-13 The National Council questions the financing of what they refer to as "earlier-than-early retirement." While normal retirement ("pensionable age" in PBSA) is age 65 years, individuals with requisite years of service can retire at age 60 with no actuarial reduction in their pension. (As described in detail elsewhere, under the terms of the plan, individuals between age 55 and 60 can retire but their pension is actuarially reduced.) The average age of retirement at CN is about 62 and this is early retirement to the National Council.

10-14 CN, periodically and selectively, has offered inducements for older employees to retire, as part of a program to reduce the workforce. The inducement has normally been a retiring allowance of a number of weeks salary multiplied by years of service paid out of general operating revenues. We also note that these inducements are offered under age and seniority provisions of union contracts.

10-15 To the extent individuals between 55 and 60 are eligible and accept these offers, National Council deems them earlier than early retirement and sees this as an "added load to the fund" due to management's action. They feel that the total pension cost should be a direct charge on general operating revenues, not on the Fund.

10-16 There is no question that early retirements are in accordance with the terms of the Plan, and the actuary will have included a cost estimate based on historical data. If CN offers encourage more individuals than assumed to accept early retirement, CN pension costs will rise. Normally, it will become evident in the valuations as an experience loss. The 1984 valuation states: "The 1982-4 period showed twice as many early retirements as allowed by our assumptions ... this trend should stabilize." This refers to all retirements prior to age 65. In fact, we are not sure how to define an earlier than early retiree. Is not anybody accepting an inducement an "earlier than early", even if over 62 years of age? How many individuals were contemplating retirement and found the inducement was a windfall?

10-17 We have difficulty with the idea that these programs are a misuse of the fund. The experience loss, if not offset by other factors, would increase the unfunded liability and must be amortized over 5 years under PBSA.

Reciprocal Transfer Agreements

- 10-18 The Sub-committee has received representations from some former CN employees who transferred from the 1959 Plan, under a reciprocal agreement, to the federal public service plan. The Sub-committee does not want to comment on particular cases, however we would like to make some general remarks on the issue of pension portability into another plan.
- 10-19 First, former CN Plan members are rightly puzzled about the amount which is transferred out of the 1959 Plan. We understand CN credits the employees with twice the amount of their contributions plus interest at a rate of 3% for years of service up to June 1976 and 4% after that. This is an arbitrary calculation of the pension credit. It bears no obvious relation to the value of the employee's vested benefit calculated according to the Plan's actuarial assumptions. If CN could show the employee how amounts received for transfer compare to the value of the vested benefit, this would go some way to reducing the confusion.
- 10-20 It should be pointed out that proposed federal pension benefits legislation would provide a less arbitrary basis for determining amounts to be returned to employees who leave before retirement. As a minimum, if the employee has contributed to the plan for at least two years, the employee must receive an amount from the employer equal to $\frac{1}{2}$ of the actuarial value of his or her benefit plus all of his or her contributions, together with interest which would "reasonably reflect" current market rates. This provision would address the concern that, at the very least, an employee should receive from a defined benefit plan a benefit comparable to that which he or she could have received from a defined contribution plan.
- 10-21 Second, employees seem to expect that amounts transferred out of the CN Plan will pay for roughly the same number of years in another plan. There are a number of reasons why this should not be the case. The plan of the new employer may have better benefits, and its actuarial assumptions may be different from those of the original plan. As a result, the employee might have to pay a significantly higher amount to buy past years in the new plan. It would seem that some prospective employees in the federal public service have not been properly informed about the costs of transferring from their old plan into the public service plan. Fuller understanding might have affected their decision.
- 10-22 This problem would also be resolved by proposed pension benefits legislation (at least for years of service after January 1987). Employees would be able to transfer amounts from their former plan into a special RRSP instead of having to leave their contributions in that plan or buy into an costly new plan.
- 10-23 **Claims regarding the federal public service are not within the Sub-committee's mandate. However, the Sub-committee respectfully proposes that the President of the Treasury Board review departmental practices with respect to accurately informing prospective employees of the consequences of a reciprocal transfer of pension plan benefits.**

Northern Allowances

- 10-24 A group of employees from NorthwTel, who are enrolled in the 1959 Plan asked the Sub-committee to recommend that the special allowance paid to them as employees in the North be considered pensionable earnings. By a resolution of the Pension Board in January 1984, as approved by the Board of Directors as Trustee, this allowance was considered not to come under the definition of pensionable earnings set out in the Plan.
- 10-25 We do not feel that we can decide this issue. It is part of the broader problem of Northern benefits — what sort of incentives should be given to those who live and work in the North and who may eventually retire there. A proper solution may well have to be worked out not only with individual employers like CN, but with the Territorial and federal governments as well.

Book/Market Valuations

- 10-26 Actuarial and accounting literature is full of papers and discussions on the question of using book value, market value or some modification for the valuation of the invested assets of a pension fund and therefore the calculation of the earnings rate. In pension funding the interest rate assumption determines the liability and therefore the funding pattern and contribution rate. The actual investment earnings rate will affect the experience gain or loss and through that subsequent contribution rates. In income determination it is easy to account for cash receipts; the problem is whether and how to bring realized and/or unrealized capital appreciation into income.
- 10-27 Rather than review all of the alternative methods, we reviewed CN's current practice for reasonableness. Reasonableness in our view means that the method is attempting to allocate income on a basis that reflects reality and is consistent with the actuarial assumptions. Prior to the 1984 valuation, CN essentially used a book value approach in the financial statements with the market value of common stocks and bonds indicated. With respect to sales of fixed income investments a deferral and amortization concept has been employed since 1979. This means that any gain or loss taken on the sale of a fixed income asset is deferred and amortized over the remaining term of the asset sold. This accounting treatment has general acceptance and has been required in life insurance statements since 1978. The method is based on the proposition that the fixed income market is efficient, i.e. there is an "interest rate" and all fixed income assets are continuously correctly priced, taking into account credit, liquidity, term, etc. The sale of one and purchase of another is an exchange of equivalents and should not give rise to an immediate capital gain or loss. The economic effect of the exchange, due to differences in credit, liquidity, term, etc. should be reflected in income over the life of the asset acquired.
- 10-28 The deferral method also means that the Investment Manager can ignore book value restraints in trading as gains or losses are amortized and the results show as net income earned on the portfolio.
- 10-29 Using book value for equity investments means that only realized capital gains or losses are brought into income. Generally accepted accounting principles do not normally permit the writing-up of assets to record unrealized gains. This creates a

number of conceptual problems for pension fund accounting. Inherent in equity investing is the concept of total return; income plus capital appreciation. Therefore, appreciation should enter into any reasonable calculation of investment return. In fact, investment return may be distorted unless the appreciation is recognized as it accrues, rather than delayed until realization. One could contemplate a successful equity investment that was never sold and where consequently the gain would never enter into income determination. On the other hand, equity markets are volatile and market values can fluctuate over a wide range from year to year. Some will say that an unrealized gain is just that, unrealized and consequently not to be recognized. Others will claim that market value is the only reality and book value is fiction.

10-30 In performing the 1984 valuation, the Actuary recast the Pension Trust Fund Financial Statements for 1982-1983-1984 to reflect a recognition each year of 20% of the realized and unrealized gains on common stocks in income. The result was to increase previously reported investment earnings as follows:

(000.000)

1982	\$ 6.7
1983	8.4
1984	20.9

10-31 The increases are the difference between 20% of the realized and unrealized gains and the previously reported realized gains. This method of writing-up book value to market value is similar to the Department of Insurance method required for life insurance companies. CN is using 20% while the Insurance Department originally specified 7% in 1978 and raised it to 15% in 1984. A formula recognizes that the common stock market values fluctuate, and attempts to spread gains (or losses) over a reasonable time period. Any formula is subjective and our actuary felt an argument could be made for a more aggressive approach.

10-32 Notwithstanding that comment we conclude that the adoption of this current technique is reasonable. We would note that real estate and oil and gas properties — two other equity investments — continue to be carried at unadjusted book value. Excluding these investments, CN had, at the end of 1984 unrealized capital appreciation in excess of \$350 million, which will move into the income account through time and is one reason we do not recommend splitting the fund.

10-33

Common Stocks

(as reported in financial statements)

	Book Value	(000 \$) Market Value	Realized Gains
1978	648,370	585,506	N/A
1979	733,297	633,435	N/A
1980	799,765	687,372	82,700
1981	1,035,646	1,148,109	106,700
1982	1,123,564	1,266,826	26,000
1983	1,066,217	1,478,204	91,400
1984	1,169,307	1,561,107	73,900

10-34 Another advantage of the formula approach is that it eliminates any concerns the Investment Manager may have about the effect on the Income account of trading the common stock portfolio. It is a truism of good investment management not to be inhibited by book values.

Buy-Back of Pension Service

10-35 On five different occasions CN has offered members of the 1935 Plan the opportunity to improve their pension benefit under the 1959 Plan by transferring service credits. These offers involve "buy-backs"; the making of contributions, at interest, covering those years of service when the individual was not a member of the 1959 Plan.

10-36 We heard complaints of two types concerning the offer in 1982. The first was from individuals who could not understand how the cost was calculated and, in any event, thought it too high. The second was from a group of individuals who felt they had been unreasonably denied the opportunity to buy-back through no fault of their own.

10-37 The 1982 buy-back offer, like the previous one, was the result of union-management negotiations. It allowed all those who had joined the 1959 Plan in 1978, and who had accepted the first 120 month (10 year) buy-back offer in 1979, to buy back all years of service. The procedure, including the rates of interest to be used in calculating the amount to be charged (the deficiency in CN terms), was included in the collective agreement. The interest rate for accruing the amounts owing was 7½% and the interest to be charged on allowed periodic repayments was to be consistent with consumer loan rates charged by banks. In 1982 that rate was set at 8½%.

10-38 The process was difficult to understand because for each year the actual annual 1935 contributions were subtracted from the required annual 1959 contributions and the difference was accrued at 7½%. This was the amount owing. As a result the value of the 1935 contributions was never quoted and to some plan members seemed to have disappeared with no accounting. Secondly, the employees failed to understand that even small contributions each year from sometime in the late 1940's through 1968 when compounded at interest to 1982 could become very large amounts. One dollar compounded at 7½% for 25 years becomes eight dollars and seventy-five cents — an increase of 875%. Again, we have evidence of CN's inability to communicate effectively something which in this case was a very attractive benefit. On the basis of the data submitted by one individual, the cost to purchase 22 years of past service was correctly calculated at \$16,000. While a not insignificant sum to anyone, the benefit purchased (22 multiplied by 2% in turn multiplied by final average salary) would repay that amount quickly on retirement.

10-39 We conclude that both the offering of a buy-back and the calculation procedure were very favourable for employees. They cost CN significant amounts of money, which showed as an increase in the unfunded liability. Whether the process and the benefit was well explained is open to question.

CONCLUSIONS

Not all of the concerns expressed to the Sub-committee can be addressed in the form of recommendations. Certain questions were raised about the CN Plan and Fund which we found it important to answer. Still other issues were raised with respect to which a recommendation was not appropriate. Our conclusions regarding these issues are summarized below.

With respect to pensioner claims against the CN Pension Fund

3-42 There are no hidden surpluses in the CN Pension Fund. CN has not misappropriated earnings by failing to pay proper rates of interest on the unfunded liability, or by failing to pay its fair share of Plan costs, or by the misuse of actuarial assumptions. CN's financial statements have not been misleading because they fail to record special payments as interest payments on the Fund rather than Plan contributions. That we make these findings does not mean that we have not understood what pensioners have been saying to us or that we lack compassion. We know that pension benefits have been severely eroded by inflation. We understand the situation of survivors and those pensioners who retired before benefits were improved in 1975. We understand that pensioners would try to show that the money for the improvements they seek has been in their Fund all along or is otherwise owing to them. Unfortunately, this is not true. Any recommendation that the Sub-committee makes to improve payments to pensioners will increase costs to CN.

With respect to the trusteeship of the Plan and other concerns regarding Plan administration

6-14 Although changes in the trustee arrangements will not increase pension benefits or cause CN to change its actions in any way at all, the Sub-committee feels that CN

27 should not continue to be the trustee of the Plan. It is clear to us, as it was 10 years earlier to Dr. Hall, that a number of pensioners do not trust CN to manage Plan funds without regard to CN's own interest. They are wrong in fact. We have found that CN has managed the Fund effectively. (We emphasize that Dr. Hall came to the same conclusion.) We have found no evidence that CN as trustee has acted otherwise than on behalf of Plan beneficiaries, and we conclude that CN has been a responsible trustee. But the facts are not at issue here, and it is not on that basis that we recommend a change. Rather, we think it important to eliminate the perception that CN may be biased in its dealings with the Plan. To borrow the words of our legal adviser, we favour a "visibly detached and disinterested trusteeship" to which employees and pensioners can look for objectivity. We emphasize the word "visibly". We should point out that proposed federal pension benefits legislation would seem to permit CN's current arrangement, whatever its legality under present legislation. We would still conclude that the present arrangement be changed. We are critical of the CN for not having done so some 10 years ago.

With respect to CN's investment practices as trustee

9-2 While both the CN National Council of CN Pensioners and CREPA were complimentary towards the CN Investment Division in varying degrees, the testimony of others again revealed the mistrust that pervades the relationship between the employees, pensioners and CN. This is a recurring theme in our review of the CN Pension System, and we cannot stress too often that this is the fault of CN management. We heard accusations, generally qualified by the acknowledgement that no firm evidence was available, that the pension trust funds were being used to further CN's own financial interests. This was done directly, it was alleged, by investing in CN related projects or indirectly by lending money to CN at favourable rates. In addition, the competency of the Investment Division was questioned. The Sub-committee concludes that these accusations are without foundation. They are based on assumptions and rumours which arise from a lack of information.

With respect to Blue Cross coverage and related issues

10-11 The Sub-committee wishes to comment generally on the matter of pension-related benefits. Over the years pensioners have been given or have won for themselves certain advantages from the railway companies — both CN and CP. It would appear, though, that when it is no longer convenient to benefit pensioners, decisions are taken which diminish or eliminate their benefits without consultation with them and without any real desire to make the protection of pensioner interests part of the decision making process. This seems to have been the case with respect to Blue Cross coverage. We have heard from a number of pensioners of Canadian Pacific Railway who feel that this is true of the decision to take away their railway passes. We strongly disapprove of this attitude to pensioner interests. Whether they are legally protected or not, these interests are not expendable. Railways and unions must find ways to incorporate pensioner concerns fairly into the negotiating process. If this is not done, inevitably they will be forced to accept unwelcome decisions formulated by Parliament.

With respect to Plan disability benefit

- 10-12 We conclude that CN and the railway unions should consider providing better disability benefits for unionized employees outside the pension plan.

Chapter 1: Description of the CN Pension System

There are no recommendations in this chapter.

Chapter 2: Problems with the CN Pension Plan

There are no recommendations in this chapter.

Chapter 3: Pensioners' Claims

- 1) The Sub-committee recommends that the Negotiations of the Pension Benefits Standards Act require employers to apply an actuarial method to reduce or eliminate an actuarial liability from that of the Pension Benefits Standards Act current service contributions.

Chapter 4: A Solution for Current Pensioners and Survivors

4.1) The Sub-committee recommends that:

(a) for retirees subject to the 1984 Pension Plan should be identical with between active and pensioners as of January 1, 1984, actuarial assumptions should be used for interest rate and mortality rate assumptions for the pensioners and should remain fixed as of the 1984 actuarial valuation; the assets of the Fund should remain intact.

SUMMARY OF RECOMMENDATIONS

Chapter 1 Description of the CN Pension System

There are no recommendations in this chapter.

Chapter 2 Problems with the CN Pension Plan

There are no recommendations in this chapter.

Chapter 3 Pensioners' Claims

- 3.1 The Sub-committee recommends that the Regulations of the *Pension Benefits Standards Act* require employers to apply an experience surplus to reduce or eliminate an unfunded liability first, and to apply the remainder if any, to reduce current service contributions.

Chapter 4 A Solution for Current Pensioners and Survivors

4.1 The Sub-committee recommends that:

- (a) for valuation purposes the CN Pension Plan should be notionally split between actives and pensioners as of January 1, 1988: valuations should be made for these two groups on the basis of assumptions appropriate for each group; the interest rate and mortality rate assumptions for the pensioner fund should remain fixed as of the 1984 actuarial valuation; the assets of the Fund should remain intact;

- (b) the pensioner fund should bear a fair share of the unfunded liability;
- (c) because an experience gain in the pensioner fund would be a measure of the cross-subsidization which currently exists between actives and pensioners, the experience gain as defined in paragraph 4-9 should be used to adjust pensions-in-pay, including those of survivors;
- (d) any experience deficiencies in the pensioner fund relative to the 1984 assumptions should be made up by CN;
- (e) the amount of adjustment to pensions-in-pay should be consistent with a formula which gives amounts to present pensioners and survivors, in order to relieve some of the impact of inflation, but which gives larger amounts to those who retired before 1976, in order to take account of their particular situation;
- (f) because the experience gain will fluctuate, the decision to adjust pensions and the determination of the amount of the adjustment should be left to the discretion of the Plan trustees constituted according to our recommendation 6-1, on the recommendation of a sub-committee of the Pension Board, made up of pensioners and CN officials, as proposed in that recommendation;
- (g) the CN Pension Plan and other relevant documents should be amended to reflect these recommendations.

4.2 The Sub-committee recommends:

- (a) that a measure of inflation protection be a priority item at the next round of contract negotiations between CN and the railway unions, and that the matter be bargained with a serious intent to reach a solution;
- (b) if the parties fail to reach a solution or if the solution fails to provide a reasonable measure of inflation protection, the government itself should introduce legislation providing a reasonable measure of inflation protection in the CN Plan, the cost to be borne fairly by CN and its employees.

Chapter 5 Survivor Benefits

5.1 The Sub-committee recommends that current survivors and survivors of pensioners currently in the Plan as of January 1, 1987 receive a benefit which is equal to 60% of the original benefit (together with whatever adjustments have been made to the benefit in the past). This should be in addition to the recommendations made for current pensioners and survivors in Chapter Four; the increased survivor benefit would form the base on which to determine the Chapter Four calculations.

5.2 The Sub-committee recommends:

- (a) that those who marry Plan members immediately before or sometime after retirement be eligible for survivor benefits;

- (b) and that the benefits of survivors not be reduced because of the age difference between themselves and the Plan member.

Chapter 6 Eliminating Mistrust — Pension Board and Trusteeship

6.1 The Sub-committee recommends that:

- (a) the Plan rules be changed to provide for a new Pension Board;
- (b) the proposed Pension Board be composed of 5 representatives each from CN, unions, and pensioners;
- (c) CN members include one representative from middle-management;
- (d) there be one pensioner representative from each CN Regional Division, the representatives to be nominated and elected by mail;
- (e) a sub-committee of the proposed Pension Board composed of the CN and pensioner members be responsible for the distribution of the experience surplus attributed to pensioners as proposed in Recommendation 4-1; pensioners should be given all the information necessary in a form which they can understand to make proper decisions;
- (f) the full Pension Board should be required to reconsider its decisions regarding the interpretation of the Plan at the request of anyone eligible to receive a benefit;
 - the request must be submitted within a reasonable period of time after the award is made;
 - the applicant must be given the opportunity to be heard;
- (g) current pensioners should be allowed to request a Pension Board review regardless of the time at which a decision about their benefit was made; in their case only, special and favourable weight should be attached to their evidence;
- (h) the full Pension Board should be given express powers to consider and propose solutions to pensioner concerns;
- (i) there should be 5 trustees of the CN Pension Plan appointed by Governor-in-Council;
- (j) the criteria for appointment should be the same as that for the appointment to the board of directors of any Crown corporation;
- (k) the trustees should retain the powers of the present trustee (the CN);
- (l) the trustees should be given the discretion to implement a distribution of the experience gain attributable to pensioners recommended by the Pension Board sub-committee as proposed in Recommendation 4-1;
- (m) the trustees should be expressly given the power of review over decisions of the Pension Board regarding the interpretation of the Pension Plan;
- (n) the CN should have a trust deed prepared for the Pension Plan.

Chapter 7 Eliminating Mistrust — Disclosure

7.1 The Sub-committee recommends that in addition to or as complementary to the provisions of Bill C-90, the proposed *Pension Benefits Standards Act*, as introduced in December, 1985:

- (a) CN provide all pensioners with the following:
- (i) a summary of the information contained in the annual Report of the Investment Division;
 - (ii) a summary of information and recommendations concerning funding contained in each actuarial valuation.

This information should be presented intelligibly in “Keeping Track”, or in some other similar way.

- (b) CN provide all active employees with the following:
- (i) the information described in paragraphs (a)(i) and (a)(ii) above;
 - (ii) financial data including,
 - cumulative contributions and interest to previous year
 - member contributions for current year
 - interest credited for current year
 - cumulative contributions and interest to current year
 - the rate of interest being credited as at year-end;
 - (iii) personal data including,
 - date of birth
 - date of entry into plan
 - pensionable service accrued to date
 - date of normal retirement
 - declaration designating a spouse as the survivor and any other relevant declarations regarding the survivor benefit;
 - (iv) general data including,
 - an explanation of how the benefit will be calculated
 - the effect of C/QPP integration
 - how the vesting rules apply to the member years of service.

7.2 The Sub-committee recommends that the Superintendent of Insurance consider the possibility of prescribing for the purposes of pension benefits legislation the set of financial statements to be issued.

Chapter 8 Integration: An Example of Failure to Communicate

There are no recommendations in this chapter.

Chapter 9 Investments

GLOSSARY

There are no recommendations in this chapter.

Chapter 10 Additional Subjects: Intercolonial and Prince Edward Island Railways Employees' Provident Fund

10.1 The Sub-committee recommends that

- (a) the Minister of Transport introduce legislation to include a 60% survivor benefit retroactively into the arrangements of the Provident Fund, and to adjust Fund benefits as set out in our Recommendations 4-1 and 5-1;
- (b) the government fully fund these improvements;
- (c) the trustees of CN hold the funds and administer the Fund arrangements separately from the CN Plan on behalf of the Minister of Transport;

GLOSSARY

Accrued Pension Amount of pension built up by a plan member according to length of service, earnings, and so on, up to a given time.

Actuarial Assumptions Factors that enter into the calculations of pension plan costs; for example, mortality rates, employee turnover, salary levels, investment earnings.

Actuarial Valuation Examination of a pension plan by an actuary to assess the solvency of the plan and determine the level of contributions required to maintain its solvency.

Ad Hoc Adjustments Adjustments of pensions being paid on an irregular, non-contractual basis.

Annuity A payment of money commencing at a predetermined time or event and made annually or at more frequent intervals, either during the continuance of a given life or a combination of lives, or for a specified number of years.

Average Industrial Wage (AIW) Average earnings for the Industrial Aggregate as measured by Statistics Canada and reported in Employment Earnings and Hours. This figure is used as a proxy for average wages and salaries.

Benefit A general term applied to any form of payment that may be made to a person under the terms of a pension plan, depending on the circumstances.

Benefit Formula A provision in a pension plan that established the method whereby the amount of an employee's pension is to be calculated, the amount being determined by multiplying either some fraction of the employee's earnings, or a fixed dollar amount, by the years of service under the employer's pension plan.

Best Average Benefit Formula A benefit formula where the earnings component is the average level of earnings during a certain number of the highest paid years.

Bridging Benefit A benefit paid to ease the recipient's difficulties during a relatively short transitional period; or, in the case of retirement before age 65 under an occupational pension plan, additional amounts paid until the person reaches age 65 when OAS and C/QPP benefits will commence.

Canada Pension Plan (CPP) A mandatory earnings-related public pension plan that guarantees a pension at age 65 equal to 25% of a contributor's average previous earnings, up to a ceiling. This ceiling is based on the year's maximum pensionable earnings (YMPE), which will be \$25,800 in 1986. The CPP also provides a 60% survivor benefit. The CPP covers workers outside of Quebec. In Quebec, the Quebec Pension Plan (QPP) provides parallel coverage.

Canada/Quebec Pension Plan (C/QPP) Used when referring to the universal Public Pension Plans.

Compulsory Plan or Mandatory Plan A pension plan that eligible employees must join as a condition of employment.

Consumer Price Index (CPI) Statistics Canada's measure of the rate of inflation. It is the price of a fixed basket of goods and services relative to its price in an earlier base year.

Contributory Pension Plan A pension plan under which both the employees and their employer make contributions. The employees' contributions are usually related to their earnings.

Contribution Rate In a contributory pension plan the contribution rate is the ratio of the required contributions to the covered earnings. The term can apply to either the employee or the employer.

Current Service The pension accrued in a year by an employee as a member of a pension plan.

Death Benefit A sum of money or series of payments paid, often to a survivor but also possibly to an estate, in the event that a member of the pension plan dies before retirement.

Deferred Annuity or Vested Deferred Pension A life annuity payable beginning at some future date, usually the normal retirement age, to an employee whose membership in a pension plan has terminated after becoming vested and before the normal retirement age of the plan.

Defined Benefit Plan A pension plan that provides a pension whose amount is determined by a defined benefit formula, a formula that relates the annual or monthly amount of the pension that will be paid to the number of years of service the employee has had and also possibly some measure of average or recent levels of pay.

Defined Contribution Plan A pension plan where the benefit at retirement is not fixed in terms of a member's salary and years of participation (see Defined Benefit Plan), but is determined by the amount of annuity that the accumulated contributions plus interest can purchase at retirement. Contributions are generally fixed as a percentage of the employee's

salary and may be made by the employer and employee or by the employer alone. These are commonly called money purchase plans. RRSP's are an example of individual as opposed to group defined contribution plans.

Disability Pension Pension payable to an employee permanently incapacitated due to physical or mental disability.

Excess Interest Approach A method of adjusting pension benefits for inflation by setting the interest rate assumption at a rate that would be obtainable in an inflation-free economy. This approach therefore indexes benefits and credits by the inflationary component of interest rates, rather than by a more direct measure of inflation, such as the increase in the Consumer Price Index.

Experience Surplus (Gain) A surplus, revealed by an actuarial review of a pension plan, resulting from a difference between actual experience (investment earnings, salary levels, etc.) and assumptions made at the time of the previous valuation.

Fully Funded When applied to a pension plan, this can mean a pension plan that at any particular time has sufficient assets to provide for the payment of all pension and other benefits required to be paid under the terms of the plan in respect of service rendered by employees and former employees to date or in respect of service rendered and expected to be rendered in the future.

Funding The orderly accumulation of assets, during the working lifetime of a group of employees that, together with the earnings of the assets, are expected to provide all pension and other benefits in respect of that group as they become payable in the future.

Funded Ratio The ratio of the assets in a pension fund to the total liabilities of the pension plan. There are two main ways this ratio can be defined. The "going concern" funded ratio looks at the assets and liabilities of the plan as if it were going to continue in existence indefinitely. The "termination basis" funded ratio assumes the plan is to be wound up immediately.

Guaranteed Income Supplement (GIS) An income-tested supplemental benefit program for Old Age Security recipients. The basic income guarantee was \$338.95 per month for individuals, \$441.50 for couples in the first quarter of 1986. Benefits are lowered by 50 cents for each dollar of income, other than OAS benefits.

Indexing The automatic adjusting of pensions in pay in accordance with changes in an index such as the Consumer Price Index. This is to be distinguished from ad hoc adjustments.

Integration Provision in a pension plan which relates plan contributions and/or benefits to those of a government pension program, e.g. Canada/Quebec Pension Plan. CN formula is a step-rate one providing lower rates of benefits and contributions or annual earnings up to the YMPE. Not to be confused with Bridging Benefit.

Joint Life/ Survivor Annuity An annuity payable until the death of the retired employee (plan member) and continuing thereafter in full or (usually) in part, during the life of the survivor (spouse).

Mortality Tables Tables showing the proportion of people expected to die or survive at each year of age. Different rates apply to different types of individual (the whole population, insured lives, pensioners, men and women). These tables are used by actuaries to estimate the cost of various benefits connected with pension plans.

Occupational Pension Plan All pension plans offered by employers, whether in the private sector or the public sector.

Old Age Security (OAS) Federal flat-rate pension payable to all Canadians age 65 or over. The payment for 1986 will be \$285.20 per month in the first quarter of 1986. OAS benefits are taxable but are not included in income for purposes of computing Guaranteed Income Supplement benefits.

Pension An annuity, or in some cases a similar but non-contractual payment, paid to a retired employee. The term "pension" is also applied rather than "annuity" to the regular payments made under public pension plans where no contract has been entered into for the payment of a specific amount of annuity.

Pensions-in-pay Pension benefits that have started to be paid (in contrast to deferred pensions).

Pension Credits The value, or a measure of the value, of a pension that has been earned (but that may not come into pay for several years), or alternatively (for example in the C/QPP) the basis on which pension entitlements have been accrued.

Plan Termination Winding up or discontinuing an occupational pension plan; for example as a result of the bankruptcy of the employer.

Portability The word portability has been used in two quite different senses. Its original use in connection with the introduction of pension benefits legislation in the mid-1960's referred to the vesting provisions introduced at the time. Its current use refers to arrangements for the transfer of an employee's pension credits either to another pension plan or to a RRSP.

Present Value The current worth of an amount or series of amounts payable or receivable in the future determined by discounting the amount or amounts at a rate of interest.

Public Pension Plan A pension plan such as OAS or C/QPP provided by a government in its role as a government rather than in its role as employer.

Public Sector Plan An occupational pension plan offered by an employer in the public sector; for example, the plan for employees of federal, provincial and municipal governments, Crown corporations, school boards.

Registered Pension Plan (RPP) An occupational pension plan that, on meeting the requirements of the federal and provincial governments, has been accepted for registration (thereby qualifying for favourable tax treatment) under the Income Tax Act.

Registered Retirement Savings Plan (RRSP) An individual savings vehicle for retirement provided under the Income Tax Act; taxes are deferred on the contributions and the income they earn until the savings are withdrawn, ordinarily as a retirement annuity.

Survivor Benefits The benefits, if any, that are payable to the beneficiary, typically a spouse, of a plan member who dies. This benefit may be in the form of a pension, returned contributions, or a guaranteed period over which the plan member's pension continues to be paid after death.

Termination A severance of the relation between employer and employee, whether by deliberate withdrawal (quitting); by involuntary withdrawal owing to illness, accident, disability; or by discharge or lay-off not followed by rehiring. A generic term that includes severance for many causes other than death or retirement.

Unfunded Liability The amount, if any, by which the total value of the pensions promised under a pension plan (the actuarial value of the liabilities) exceeds the value of the assets at a point in time.

Vesting The employee's right, on termination of employment before retirement under a pension plan, to the benefit that has accrued under the normal benefit formula of a defined benefit plan, or the accumulated contributions held on his behalf in a defined contribution plan, up to the date of termination of employment; the benefit is often payable as a deferred annuity commencing at a normal retirement age.

Year's Maximum Pensionable Earnings (YMPE) The maximum earnings for which contributions can be made to the Canada or Quebec Pension Plans during the year. YMPE in 1986 is \$25,800.

ABBREVIATIONS

AIW	Average Industrial Wage
CPI	Consumer Price Index
CPP	Canada Pension Plan
C/QPP	The Canada and Quebec Pension Plans
GIS	Guaranteed Income Supplement provided under the Old Age Security Act
OAS	Old Age Security
PBSA	Pension Benefits Standards Act (which applies to pension plans in employment under federal jurisdiction)
QPP	Quebec Pension Plan
RPP	Registered Pension Plan (under Income Tax Act)
RRSP	Registered Retirement Savings Plan (under the Income Tax Act)
YMPE	Year's Maximum Pensionable Earnings (for contributions and benefit calculation purposes under the C/QPP)

Legal Opinion Prepared for the Sub-committee by Donovan W.M. Waters, Professor of Law, Barrister and Solicitor

Professor Waters, who teaches law at the University of Victoria in British Columbia, is a well-known authority on the law of trusts. He is the author of Canada's leading text on trust law, *The Law of Trusts in Canada*, (Toronto: Carswell, 1984, 2nd ed.). Professor Waters is also a trustee of a pension plan.

The opinion is divided into four sections which cover the main areas where questions regarding the legality of CN's actions arise:

- (1) ownership of the Fund, which answers the question, Who owns the Fund?
- (2) Fund administration, which deals with trustee issues, including investment decisions
- (3) CN's obligation to fund, which deals mainly with concerns surrounding the unfunded liability, as well as CN's use of the experience surplus to reduce its funding obligations
- (4) what claims, if any, CN, pensioners and actives have on Fund assets. The issue of withdrawal of a surplus is also discussed although only in a theoretical way, since a Plan cannot be in surplus where there is an unfunded liability.

CN PENSION FUND

Section 1: Ownership of the Pension Fund

1(a) Who owns the CN Pension Fund?

Answer: the CN Pension Plan takes the form, as it has done since 1935, of a “trusteed” plan. That is to say, in such a plan the assets which are to pay pensions are held by a trustee or trustees (there may be one or several) on trust for the payment of the described beneficiaries in accordance with the terms of the plan. In a fully-funded plan, which is of course the most desirable, all the moneys, which at any particular point in time are required by the trustee for pension provision purposes, have been transferred to (or settled upon) the trustee, and the trustee’s task thereafter is to invest those moneys for return and growth. In a totally unfunded plan there are no trustees because there is no fund to hold and invest, but a partly-funded plan is a trust, because, though some moneys which are to be used for the provision of pensions have been promised (usually by the employer) but not paid to the trustee, other contributions have been received, and are held by the trustee on trust.

A trustee pension plan is in law a trust like any other. Its whole conceptual basis, and the rules of law which govern it, are to be found in the law of trusts, a law which governs at one extreme the simple testamentary trust and at the other the oil and gas royalty trust or the trust for bondholders.

In trust law the trustee holds the legal title to the trust assets, and the beneficiaries’ rights in those assets are those which are set out in the trust instrument. The beneficiary’s interest is in the enjoyment of the asset and this is described as an equitable legal interest; he has no interest in or entitlement to the rights and powers associated with the disposition of legal title, or management of the assets (stocks, bonds, or other security instruments, for example). Those rights and powers are the trustee’s and the beneficiaries can only interfere, if at all, to the extent which the trust instrument (or plan) permits. Though the trustee acts on behalf of and for the exclusive benefit of the trust beneficiaries, he is not an agent — he cannot be ordered by the beneficiaries to do anything. Provided the trustee acts in accordance with the terms of the trust instrument, which describes his duties and will usually give him powers, and he also acts in accordance with the law, which governs, for instance, the standard of care, and the loyalty to the trust that he must show, the beneficiaries cannot sue him for breach of trust, or question his exercise of discretions (or powers).

It is not therefore right to say that either the trustee or the beneficiaries “own” the fund. Each has an estate (or interest) in the fund — the trustee legally, the beneficiaries equitably; together they can perhaps be said to “own”, to use a lay word, but that is as far as one can go. The trustee must manage in conformity with the law and the trust indenture; the beneficiaries’ sole rights to enjoyment are those which are described in the trust instrument — those, and no others.

1(b) Does the Pension Fund “belong” to CN?

Answer: No. The pension fund as a *trust* fund is separate and distinct from all of CN’s assets. Once assets are put into this fund to be held by the trustee (whoever that person may be), they are no longer the assets of CN, even if they came from that source, or of the

beneficiaries, though they came from that source. They are funds set apart from either the employer's or the beneficiaries' control for the sole purpose of investment and the provision of pensions, in accordance with the plan and trust law. The employees and CN as contributors are settlors of the fund, but, as with all trusts, unless powers are reserved to the settlor in the instrument, the settlor has alienated property, once it is put into the trust, and he has lost control over it as if sold or given away. Whether a pension plan is contributory or non-contributory, the employer places funds into the trust; the funds are then vested in the trustee, and the trustee's exclusive control. It is irrelevant whether the employer sees itself as responsible, or is responsible, for paying defined pension benefits. A "trusteed" plan, or self-administered, uninsured plan, inevitably gives the employer a real concern for levels of investment performance and administrative costs, when the character of the plan is defined-or unit-benefit, but the character of the fund remains a trust fund. It is also irrelevant in this regard that CN is the Trustee. CN wears two hats; (1) company and employer, (2) trustee. The two are totally distinct.

Section 2: Fund Administration

2(a) Who in Law is responsible for determining fund investment policy and investment decision-making?

Answer: First, a reference to the law of trusts. Unless the trust instrument provides otherwise, the trustee exercises the power of investment. He decides policy (e.g., the mix of growth assets and debt securities), and he is responsible for his investment consultants if he delegates to them the choice of particular investments within the policy parameters already set by the trustee. The consultants are his agents; he must personally select them, and carry out a level of supervision of their work which would be considered reasonable and prudent in the business community. However, a trustee can validly be required to seek the consent of a third party as to the investments he makes. It is often an unwise move for the settlor to give another such power, but that is another matter.

Under the terms of the Consolidated Rules (1935 and 1959) of the Plan the Company is the Trustee (1(x)), and the fund is to be administered by the Trustee, the fund not forming part of the revenues or assets of the Company. The power of investment given by the plan rules is found in Rules 3(3) and 108. See also clause 144(7). Under Consolidated By-Law No. 80 (as of 01/12/81) the Investment Committee, a body appointed by the Board of the Company and comprising a specified number of Board members and officers of the Company (1.4), is charged with reviewing the activities of the Investment Division (again Company officers), and advising the Division with respect to investments. The Committee is also generally to give approvals and take such action as the by-law contemplates (2.2). The Division appears to be responsible for the day-to-day investment "operations" of the trust fund (3.2), but policy decisions are to be "approved" by the Company's Board (3.2 and 4.1). From whom or which body policy proposals are to come is not clear in my opinion. 4.3 suggests the Division will carry any such proposals to the Board, but expressly requires the Division's proposals to have the agreement of the Investment Committee before they are taken to the Board. The Committee's advisory powers (2.2) may also possibly extend from the selection of specific investments to the origination of policy proposals, but, if this is the correct interpretation of 2.2, it would seem that the Board may also require the views of the

Division (4.3) before making any policy decision. Ultimately, whether policy proposals originate with the Division or the Committee, policy decisions are taken by the Board. When it is taking these decisions, the Board is sitting as the Trustee (Consolidated Rules, cl. 1(x)). As to investment selection, the Division and the Committee appear to be required to work together at this task, the Committee advising, and the Division making decisions and carrying out the trading (4.2).

In effect, since the Board members are both employees and agents of the Company, and the Company's officers are its employees, the Company as Trustee acts through its Board to make all investment policy and selection decisions, and to carry through the necessary trading operations. Effectively, as Trustee of the pension plan the Company acts much in the manner of a trust company.

As a closing comment in response to this question, it should be said that, even where a trustees pension plan has individuals as trustees, it is not unfamiliar to find that those trustees are required to take direction from the employer regarding the selection of securities. This is valid legally, as earlier observed; it is a reflection of the employer's concern to have a stable portfolio of investments, and an acceptable level of growth. After all, as previously noted, he is self-insured if the plan is defined benefit.

2(b) Can investment policy and decision-making legally be directed at benefitting CN as opposed to pensioners?

Answer: No. A trustee must act solely and exclusively for the beneficiaries of his trust. This is axiomatic in the law of trusts. CN, the employer, contributes to the pension fund as a settlor, but when it wears the hat of Trustee in administering the fund it has no choice but to consider only what is best for the members of the plan, i.e., the active employees, retired employees, and the other pensioners. Only the trust instrument can derogate from that selflessness, and there is nothing in the Plan Rules that I can find which allows the Trustee any permission to consider its own interests. It is subject, like all trustees in principle, to the full rigours of the rule that the trustee must make no personal profit from the trust fund, and not permit itself to be in a conflict of interest and duty situation. Investment policy decisions and investment selection can be guided, as they are controlled, by only one criterion — the best interests of the plan members. This is important, because the temptation to a self-insuring employer is to be as much concerned with conservation in order to protect his own interests, as with increasing the yield. On the other hand, though the membership is always concerned about inadequate funding, where the plan is defined benefit it can be said to be equally in the plan members' interests that the employer has the wherewithal to provide that benefit. Though the trustee's duty is to make policy decisions and investment selection solely with the best interests of the plan members in mind it must also be remembered (see the answer given here to Question 1) that the trustee is not subject to the orders of the beneficiaries. This misunderstanding of the law is commonly made. The trustee must follow the instructions of the terms of the plan, which is or is part of the Trust Deed, and in carrying out those duties and exercising those discretions, like the choice of investments, adhere to the standard of loyalty, care, and vigilance defined by law. The plan's terms and the law alone instruct the trustee.

2(c) Do pensioners have any legal rights regarding investment policy and investment decision-making? What are they?

Answer: All members of the plan, which means active, contributing employees, retired persons, and all other qualified pensioners, are entitled to require the Trustee to invest only in accordance with the plan investment power (Consolidated Rules, 3(3) and 108. See also 144(7)). If the Trustee departs from this description of permitted investments, any and all plan beneficiaries are entitled to bring action for breach of trust, and thereby to ensure that any loss caused to the trust fund is compensated for out of the Trustee's own personal assets.

This is the full scope of the beneficiaries' control over the Trustee's investment decisions and conduct. The specified investments permitted by Rule 108 are narrow in scope, being substantially limited to government guaranteed debt securities, and with such investments it would be difficult for the Trustee to be imprudent in its policy and selection, but Rule 3(3) is broader. However, prudence and care are always required of the Trustee. See *Fales v. Can. Permanent Trust Co.*, [1977] 2 S.C.R. 302, 318, 319. Failure to demonstrate prudence and care, and consequent loss, justifies the plan members' legal action.

2(d) Do pensioners alone have the rights mentioned in question (c) (i.e., are pensioners the sole beneficiaries of the trust)?

Answer: As stated in the previous answer, all trust beneficiaries have these rights. As active employees contributing to the plan they are beneficiaries. As retired employees or spouses or other persons (described in the plan) they are beneficiaries as recipients of pensions, since the Company as Trustee "delivers" the pensions.

2(e) Do you find that current trusteeship arrangements violate either the letter or the spirit of the *Present Pension Benefits Standards Act* ("PBSA")?

Answer: Yes. It is unquestionably the case that under the law of trusts a person may declare himself a trustee for others (or himself and others) of assets that he previously owned in his own right. The owner merely changes his hat from that of outright owner to that of trustee, and title will accordingly remain in his name, despite the existence of the trust. Nevertheless, this does not appear to be an arrangement which the PBSA contemplates for trustee pension plans. Regulation 11(1) of the PBSA Regs. requires the funds of a plan to be administered by a life insurance company, a corporate trustee (i.e., a trust company), individual trustees, a society established under the Pension Fund Societies Act, or the Government of Canada. Reg. 11(2) require funds, including securities, to be deposited in the name of one of the above, excepting individual trustees, or otherwise in the name of the pension plan, or individual trustees in trust for the pension plan.

I assume, though I have great difficulty in interpreting the meaning of Regulation 11(2) in this way, that, given the arrangements of the CN Pension Plan Rules and By-Law No. 80, CN claims to administer and hold the fund as an "individual trustee". If this is so, I have to assume also that CN as a corporation is empowered by its charter to exercise fiduciary powers. If I am wrong in either of these assumptions, I do not understand on what basis CN is recognized by the Superintendent of Insurance as satisfying this regulation.

If CN is regarded as meeting the requirements of this regulation, it remains the case in my opinion that CN is not meeting the spirit of this regulation. It is my opinion that this regulation is attempting to divorce the office of trusteeship from the employer and the

employees. It is attempting to bring about a visibly detached and disinterested trusteeship, to which both employee and employer can look for objectivity and professional skill. I will later suggest that in my opinion much of the dissatisfaction by employees and pensioners with the present conduct of the pension plan stems from the fact that this divorce, as I have called it, has not taken place with the CN plan. There is an ingrained suspicion, for some it is a proven fact, that with CN as both employer and trustee the corporation is utilizing its trusteeship to advance its own corporate interests, rather than those of the beneficiaries of the Plan, persons who should be the Trustee's sole concern. As I understand regulation 11, and the more so against the background of the entire PBSA and its regulations, this is the very thing which this regulation is designed to avoid.

CN's position, no doubt, is that as employer it has a real concern that the investment and administration of its plan, namely, defined benefit, shall be as stable and low cost as possible. Nevertheless, it remains the case that CN as Trustee is not permitted in law to protect or advance its own interests, as I have explained. CN is not a beneficiary of the Plan. Moreover, without employer dissatisfaction the great majority of such plans possess trust companies as the trustee, and most of the remainder possess individuals distinct from the employer. It is puzzling, therefore, given the consistent reaction of CN Plan members, to the Plan's operations, why CN has not thought fit to adopt the unequivocal recommendation of Dr. Noel Hall in his 1976 report.

2(f) Do you find that current trusteeship arrangements violate the letter or the spirit of the *proposed Pension Benefits Standards Act, 1985*, (Bill C-90), as introduced in the House of Commons on December 17, 1985?

Answer: The CN Plan is not "a multi-employer" plan, as defined in Bill C-90, nor, to my understanding, was it "established pursuant to one or more collective agreements" (s. 7(1)(a)). Therefore, s. 7(1)(a) does not appear to apply. S. 7(1)(a) requires the "administrator of a pension plan" to be "a board of trustees", or similar body described in the plan or agreed between employer and labour union. Nor, because CN is not itself "a multi-employer", does s. 7(1)(b) apply, which requires the "administrator" to be a "pension committee constituted in accordance with the terms of the pension plan." In my opinion, therefore, the "administrator of [the] pension plan" for the purposes of this section is "the employer", and under s.7(7) the "administrator" is responsible for the administration of the plan, "including the pension fund", in accordance with the Act and the regulations, and for the filing of documents.

However, under s. 7(3)(a) CN may establish a pension committee to be the "administrator", but, if it does not do so, under s. 7(3)(b), there being more than 50 members of the CN Plan, a majority of the Plan members may request that a pension committee be formed to be the "administrator", when CN must comply. The duties of the "pension committee" are set out in s. 7(6). The nature and scope of these expressed duties should particularly be noted.

Who are to be the members of a pension committee set up further to s. 7(3)(a) or (b) is not in my opinion clear. Ss. 7(4) and 7(5) each prescribe at least one representative of the plan members, chosen by the members (the members by majority are required to ask for this representative if CN voluntarily sets up a pension committee). However, "pension

committee" is not defined in s. 2, or otherwise in the Act, and it would therefore appear that CN as the employer may determine the size and the remaining members of the committee.

Should CN determine to set up a pension committee, as it can do under s. 7(3)(a), or in the alternative a majority of Plan members were to request a committee under s. 7(3)(b), the question then arises as to what relationship this committee as "the administrator of [the] pension plan" would have with the existing Pension Board (Rules 2, 102, and 101(c) of the 1959 and 1935 Plans respectively). This Board, which Rule 2 lays down is to "administer" the Plan(s), is already a body balanced in its make-up between persons nominated or approved by the employer and other persons nominated or approved by the union, but in the event of the inability of the Board to make a decision on any matter within its jurisdiction the matter is to be referred to the CN Board (Rule 2(9)), and the Pension Board's powers (or jurisdiction) as set out in Rule 2(10) are different from those given to the "pension committee" by s. 7(6)). It is also clear that under s. 7(6)(c) further duties may be imposed upon "pension committees" under regulations yet to appear.

Trusteeship and investment present a particular problem. Does the proposed Act envisage the "pension committee" being the trustee and having the power of investment? Bill C-90, s. 7(7), makes the pension committee responsible as administrator for "administering ... the pension fund", but the Act nowhere gives the duty or power of investment to this committee in express terms. S. 8(3) charges the administrator to "administer the ... pension fund so as to protect the pension benefits" of the members and other beneficiaries of the plan, and s. 8(4) imposes a standard of care upon the administrator which trust lawyers associate with the express trustee who has custodianship of, and investment powers over, the trust property. S. 8(5) underlines this comparison with the express trustee. S. 9(4) applies only to any schedule of permitted investments, however, and otherwise s. 9 is silent on the issue. The problem of what Bill C-90 intends for trustee pension plans no doubt stems from the fact that the Act applies to all types of pension plan, of which the trustee pension plan is but one. However, in my opinion, though I admit to some doubt, especially in view of s. 7(6), the better interpretation of Bill C-90 is that the Act makes the "administrator" trustee of the pension fund, and responsible for the investment policy and selection. This seems the more likely intention of s. 7(7).

The CN Plan on the other hand makes CN the Trustee, and gives responsibility for investment policy and selection to the CN Board; that Board in large measure works through the Investment Committee and the Investment Division (see answer to Question 2(a), above). If I am correct in my interpretation of Bill C-90, that Act, if enacted, would enable the members, if they chose, to see that a pension committee is established, and that a person chosen by themselves is a member of that committee. If I am wrong, two situations occur. First, as to the duty and power of investment, the Investment Committee, the Investment Division, and the CN Board would all three continue to exercise the authority set out in the Plan. Secondly as to trusteeship (i.e., vested title to investments), CN would remain as Trustee, but would keep the pension committee fully informed (s. 7(8)) in order that the committee might properly discharge its duty (s. 7(6)(b)) "to review, at least once every year, the financial, actuarial and administrative aspects of the plan". Whether the existing Pension Board has the power to discharge this task under rule 2(10)(b) I doubt, even in the light of Rule 2(10)(d). Bill C-90, s. 7(6)(b), requires, I would think, some form of accounting by the Trustee to the pension committee.

I conclude, therefore, that the current trusteeship arrangements of the CN Plan cannot be said to violate the letter of Bill C-90, except to the extent that the trusteeship of the CN Board and the investment authority of the CN Board, Investment Committee and Investment Division, could be brought to a close. If the proposed Act contemplates that the pension committee shall be the trustee of the fund, and determine investment policy and selection, which I consider the more persuasive interpretation, then a majority of the members have the power to ensure that such a pension committee is formed. If the Act does not include custodian trusteeship within the concept of "administrator", then the present trusteeship of the CN Plan remains in place. If the Act does not include investment policy and selection within the role of the "administrator" (and ss. 7(6) and 7(7), read together, could lead to this interpretation, but I find it more difficult to believe this is the intention), then the CN Plan provisions on this matter also remain in place.

Though in the light of Dr. Noel Hall's recommendation, and my own (see answer to Question 2(d)), s. 7(1)(c) appears to reflect a contrary line of thought, it is my opinion that Bill C-90 is attempting to secure a detached and impartial administrative agency through the device of a "pension committee". Whether s. 7, as at present conceived, achieves this end (certainly for trustee pension plans) I respectfully doubt, in particular because I find nothing on the size and composition of the committee, other than the members' representative. Given the silence on this last matter, I cannot say with any conviction that the spirit of Bill C-90 is contrary to the terms of the CN Plan. It would appear that the employer's nominees to the proposed pension committee would have voting control. But again, I would reiterate, the proposed Act is enabling; the CN Plan members would have it in their power to determine whether there should be a "pension committee".

Section 3: Obligations of CN to Fund the Pension Plan

3(a) Has CN a legal responsibility to pay off an initial unfunded liability or an experience deficiency, as defined by the present *Pension Benefits Standards Act*, as soon as it is incurred?

Answer: In my opinion, no. Under the law of trusts a trustee has the obligation to care for the trust property in his name, and to exercise any rights of action he has as trustee to obtain for the trust any property intended from the trust. For example, he must ensure shares are registered in his name, and acquire possession on the termination of leases in place on trust-owned fee simple land when the trust takes effect. He must also pursue the rights he has arising out of contracts into which he has entered. If, for instance, he has entered into a contract whereby another agrees for consideration to supply certain assets to the trust, the trustee must pursue his contractual remedies if the other fails to perform. However, if gratuitously X states his intention to transfer cash to T, who is the trustee of an existing trust for the benefit of B, X's object being that the trust fund shall be augmented, and greater benefit be available for B, there is nothing T or B can do if X changes his mind before transferring the cash. B may be the employee of X, but only if there is a contract between X and B requiring the provision can B sue X for the provision of the cash to T. T has no *personal* right of action on that contract, even if there is a contract between X and B. T may now sue, but only as B's trustee.

It follows that, if instead of gratuitously promising to donate the cash, X enters into an agreement with Y, the union representing X's employees, that X will do certain things, X and Y act as strangers to the trust (neither is acting in the contract as a trustee, and neither is a beneficiary of the trust), and neither T nor B has any rights to sue on the contract made between X and Y. Moreover, whether Y itself has an action on the contract against X depends on what X has agreed to do. If X has agreed that it will increase the pensions of the retired employees, that is one thing. Increase of the pensions of persons retired may or may not require X to pay sums immediately into the trust fund. It all depends what the parties have agreed, and on the manner in which the plan requires augmentation of the pensions to be made, i.e., payments from the trustee, or directly from the employer.

So far as the pensions of active employees are concerned, X may have agreed to ensure that those employees retire at certain higher benefit levels than are now in place. That is another thing. Y, the union, has no right to require of X that X fund the trust in sums which will ultimately produce these higher levels unless X has agreed (1) to ensure pensions at those levels, *and* (2) to supply cash to the trust fund at once for the purpose of supplying the wherewithal to meet those levels when the time comes. It also has to be said that, even if X and Y have agreed to both (1) *and* (2), neither T nor B has any ability to bring legal action on the basis of that agreement because neither was party to the contract. It is most unlikely that all active and retired employees, and other pensioners such as spouses, would have been made party to the agreement between X and Y; certainly in my experience I have never seen it attempted. But X or Y may have joined T as a party to the contract, and, if this happened, T can sue on that agreement (if legally enforceable agreement it is). But, in his turn, T also can then only enforce the terms of that agreement, and, if cash is to be provided at once by X, that obligation must exist in the agreement.

The reason why I have answered the question put to me by replying, No, is because there is no obligation under the PBSA upon the employer to fund immediately (s. 11(a) of the Act and reg. 12 make careful provision for how funding shall be made), and I can see no immediate funding obligation upon CN in the Plan. The only consequent obligation upon CN is to adhere to the funding requirements of Regulation 12, either as specified in the regulation or as stipulated by the Superintendent. That in my opinion concludes the matter.

However, even were there is an obligation upon CN to fund at once, it appears to me that CN entered into the collective agreement with the union solely as the employer. I am not aware of any evidence that shows CN also expressly entered into the agreement in its capacity as trustee of the plan. Whether it could be said impliedly to have entered into that agreement wearing the hats of both employer and trustee is more difficult to answer. I have seen no evidence from the documentation available to me which would justify the drawing of that implication, and in my opinion it cannot be implied from the mere fact that the employer is also the trustee. The difficulty emanates from the fact that CN continues to wear the two hats. It is vulnerable to the argument that what it agrees to do as an employer, it cannot refuse to do, contract aside, as trustee.

On the assumption then that CN neither expressly nor impliedly entered into the collective agreement other than as an employer, CN as trustee would have no action on the agreement. This would be so even had the collective agreement legally obligated CN to fund the trust at once — and no evidence suggests it does. Nor would the union have an action, because the union is a different body from the membership of the plan, which comprises active employees, retired employees and other pensioners. There is also no evidence that the

union entered into the collective agreement for pension plan purposes, as the agent of all the plan members. I make no comment on the additional fact that the pension plan aspects of the 1973 agreement were not part of the formal record of the agreement, though CN agreed to be bound by the terms of the consensus and conciliation.

3(b) To make question 3(a) more specific, in 1973 and 1975 the CN made Plan improvements which increased the unfunded liability by \$197.3 million and \$49.9 million respectively. [This was the introduction of the 2% benefit made retroactive to all years of service prior to 1975.] Also, from 1971 to 1985 CN has given ad hoc adjustments to pensioners which increased the unfunded liability by \$365 million. Was CN legally obliged to pay \$197.3 million into the Fund in 1973, \$49.9 million in 1975, etc?

Answer: In my opinion, as explained in my previous answer, No. All that I would add here is that, though the 1935 plan was a type of money purchase plan, the 1959 plan is clearly solely a defined benefit plan. Whatever might be said as to the 1935 plan (and even here I can find in the plan no obligation on CN to fund the plan at once; see Rule 150 (1935 plan)), the 1959 plan entitles members to a pension based not upon fund size and combined contribution accounts, but upon a formula. Provided that the 1959 plan is actuarially sound at each triennial review, and CN has adhered to the funding obligations of PBSA Reg. 12, including such requirements as the Superintendent has imposed under authority of that regulation, I can see no further immediate funding obligation of CN with respect to the 1973 and 1975 formula improvements (increases of the multiplier percentage component, and retroactivity of the increase). See Rule 27 (1959 plan). Each member is entitled to the formula pension on his or her retirement, and, if the Superintendent is satisfied that the letter of Regulation 12 has been met, plus any requirements that he has made under that Regulation, the members have everything to which they are entitled, provided none has been denied the formula benefit. I would draw attention to Regulation 12(8) which clearly fixes the funding obligation when the plan has been amended.

So far as the ad hoc adjustments between 1971 and 1985 are concerned, my reasoning has to be the same. I continue to assume that, despite the degree of non-funding, the requirements of Reg. 12, and of the Superintendent further to that Regulation, have been met.

3(c) If CN was not obliged to pay the monies referred to in 3(a) and 3(b) into the Fund at the time the improvements and adjustments were promised, was it obliged to treat these monies as a loan from the Fund, and to pay interest on the monies at a rate currently obtainable on the market?

Answer: In my opinion, No. If CN has no obligation under the PBSA, or under the terms of the plan, to fund the plan at once to the extent of these sums (the 1973 and 1975 formula increases, and the 1971-85 ad hoc adjustments), then I cannot see upon what basis it could be said to have notionally funded the trust, and then notionally borrowed the same sums from the trust. If CN had no *obligation* to pay these moneys into the plan at the time they were promised, then, as it seems to me, one cannot assume performance of a non-existent obligation, and a loan-back. Anything CN enforceably promised the union can be the subject-matter of legal proceedings brought by the union, but I can see no evidence of a promise to fund at once, even between the employer and the employee.

3(d) If the answers to 3(a)-(c) are in the negative and if they are based on provisions of the present *Pension Benefits Standards Act*, suppose the relevant provisions of the Act did not exist; would CN then have any obligation — based on trust law, contract law, or some other basis — to keep its Plan fully funded at all times, or at least to pay current interest rates on amounts paid over time to make the Plan fully funded?

Answer: In my opinion, No. Under trust law there is no obligation upon anyone to supply assets to a trust. This is why a donor must either have transferred assets effectively to the trust, or have done all he or she can do to complete the transfer. See *Milroy v. Lord* (1862), 45 E.R. 1185. A would-be settlor may contract with the trustee (or a beneficiary of the trust) that he (the settlor) will transfer assets, and then the trust is considered to be funded because the trustee has an action for specific performance or compensatory damages, if the would-be settlor later refuses to carry out his obligation. In the present case the employer has either unilaterally declared that it will see that existing or future pensions are at a stated level, or it has a collective agreement with the union that it will see that pensions of a certain level are paid (whether through formula enhancement or ad hoc increases). I repeat that there is no evidence available to me (1) that the employer agreed with the union as employer *and* trustee for the plan, or (2) that it was agreed that the employer would fund at once upon giving the undertaking.

Even if one approaches the collective agreement as a binding contract, it will be apparent from the above that the law of contract does not produce a different answer. I am not aware of another basis in law which would produce a different result.

I would only add that the interest rate assumption of 4% used as of 1960, and the 7½% as of 1968, would have been assumptions for the purposes of calculating actuarially the funds necessary to meet benefits promised. Again, the member's benefit is merely to receive the pension produced by the application of the formula to his particular circumstances.

3(e) In 1981 the Fund had an experience surplus. In 1983 and 1984 CN used this surplus to reduce its current service contributions for those years to zero. Was CN within its rights in doing so?

Answer: There is nothing in the 1935 and 1959 Consolidated Rules which would appear to deny this right to CN. However, it is possible that an argument could be mounted against this right on the basis of a strict reading of Regulation 12(2) to the PBSA:

“Subject to subsections (2.1) to (2.11), every employer *shall pay into a pension plan*

(a) in respect of current service, an amount of contributions equal to“.
(underlining supplied)

Once funds are in the plan it is arguable that they cannot thereafter be employed for the purpose of meeting current service contribution obligations, or any other of the liability, experience deficiency, or test deficiency, situations described in Regulation 12(2). It would be my opinion, however, that such an argument, if correct, would have very strange results. It would mean that, though the object of the Act and the regulations is to ensure a periodic actuarial assessment that the plan is sound and thereto a level of funding, nevertheless, if a surplus is discovered on the occasion of any assessment, that surplus cannot be employed for the purpose of meeting current or future liabilities or deficiency correction. Fresh funds must

be put into the plan. This must be wrong. The object of a plan of a defined benefit character is to establish the liability of the employer to provide a pension determined by a formula, which itself ignores the amount actually in the trust fund. The formula is not per se concerned with the size of any fund. With any other employer than government, it is obviously a concern of members of the plan that the employer will still be in existence when retirement or resignation dates occur, and, if existing, be in a financial position to meet its obligations to the members. But the *advantage* of a fund set apart in a trust distinct from the employer's own assets does not make a fund a *necessity* to the operation of a defined benefit plan. It follows in my opinion that, provided the promised benefits can be met from the fund, any excess funding can be called upon by the employer to meet other current or future liabilities, until, if at all, deficiency occurs.

The Department of National Revenue requires surplus in a defined benefit plan to be expended upon employer "contributions on account of current or past service in the current and subsequent years". This is by way of alternative to the employer being refunded the surplus in excess of sums needed as employer current service contributions for the next 2 years. However, Information Circular 72-13R7, para. 39(a), can only properly address the issue for the purposes of the *Income Tax Act (Canada)*, as the opening words of the subparagraph itself make clear.

3(f)(i) Does CN as trustee have the power to force CN the employer to pay amounts owing to the Plan for "current service" and for "special payments" on the unfunded liability, as these terms are defined in the current *Pension Benefits Standards Act* and its Regulations?

Answer: In my opinion, yes. In my answer to Question 3(c) I suggested that CN is "vulnerable to the argument that what it agrees to do as an employer, it cannot refuse to do, contract aside, as a trustee." I said, "The difficulty emanates from the fact that CN continues to wear two hats". There I was dealing with the issue of the CN as employer entering into a collective agreement with the union of employees, and I was raising the question of whether CN as trustee might be said to have impliedly entered into the agreement when CN as employer bound itself (as I was supposing) to fund the Plan at once for promised improvement of benefits.

Here the first issue is how CN as employer becomes bound to make "current service" payments and "special payments". In my answer to Question 3(b) I observed that Rule 27 (1959 Plan) obligates CN as employer to make such payments in each year as it is required to make under the PBSA. This applies both to "current service" payments and "special payments". Reg. 12(2)(a), further to the PBSA, requires "current service" payments to be made each year, and Reg. 12(2)(c) and (d) specify the periods of time during which "special payments" must be made. Reg. 12(2.1) – (2.9) offers CN as employer an elective alternative as to the mode of making "special payments". Reg. 12(2.10) and (4) specify the latest dates by which payments due, further to the Regulation, must be made. The employer breaches these obligations on pain of withdrawal of approval of the plan by the Superintendent, and is also in breach of his statutory obligations to the administrator of the plan (Reg. 12).

If CN as employer is statutorily obligated to make payments of any kind, and there were to be an independent administrator of the plan as trustee, it is my opinion that the trustee has the duty as trustee to demand payment from the employer. Such is the role of a trustee that I do not consider the trustee needs authority from the Act or the regulations in

order to bring its own action, though admittedly this is arguable. If the trustee can enforce employer compliance with the PBSA, I cannot see that the situation is different because CN is also the trustee. The two hats that it wears are quite distinct, and of course the bizarre situation in which it finds itself directly stems from the fact that by playing both roles it courts the possibilities that its position as employer comes into conflict with its position as trustee, a person who must act solely for the benefit of the plan members, including those on pension.

CN as trustee has the obligation to demand payments due under the Regulation, and in my opinion as trustee (or administrator) it has the authority to act. How it must act is more difficult to answer, because if legal action became necessary CN would be suing itself. I assume the law of trusts of the governing jurisdiction would apply, namely, that the Plan members would bring action against CN as trustee, joining CN (as employer) as co-defendant. Effectively they treat their trustee as a hostile party, and step into the trustee's shoes to press the Plan's right of action against the employer.

3(f)(ii) If the answer to (i) is in the affirmative, is CN as trustee obliged to ask for payment as soon as payments are due but not paid, or does CN as trustee have the discretion as to whether and when to ask for payment?

Answer: A trustee must enforce any rights he has as trustee under the instrument, or case law, or statute. He acts exclusively for the benefit of the trust beneficiaries, and, unless the instrument or the statute in question expressly confers discretion upon him, he has no option but to defend and pursue the trust's rights with "vigilance, prudence and sagacity" (Dickson J. in *Fales v. Canada Permanent Trust Co.*, [1971] 2 S.C.R. 302 at 318). This is his duty of care. The trustee requires of CN what CN as employer is required to do under the Plan, the PBSA, and the Regulations.

3(f)(iii) If the answers to (i) and (ii) are based on provisions of the present *Pension Benefits Standards Act*, suppose the relevant provisions of the Act did not exist; would CN as trustee have the power and be under an obligation to demand payment of amounts owing from CN for current service and as special payments?

Answer: My previous answer concluded that CN as employer had an obligation under the PBSA to make current and special payments, and I also conclude that in those circumstances a trustee has an obligation to pursue what remedies he has on behalf of the trust under the law of trusts. It is assumed that the employer has breached his statutory obligation to fund the trust (the plan), but it is also clear that the PBSA does not expressly give a right of action to the trustee (or administrator) to compel the performance of that statutory obligation. The trustee's powers and obligations can therefore only come from the Trust Deed (i.e., the Plan) and the law of trusts.

If the PBSA did not exist, the only power of the trustee to enforce payments would be those payments obligated by the Plan. The Plan would then obligate none, because Rule 27 assumes the existence of the Act. However, if the Plan were to contain an independent clause requiring the employer as one party to the Plan to make any payments, it would be the obligation of the trustee as the other party, or on behalf of the trust beneficiaries as the other party, to demand, and bring action to compel, payment. There is nothing in the Plan requiring the trustee to act or not to act or exercise its discretion about whether to act, and

therefore the trustee has this clear obligation to act further to the law of trusts. (I am assuming that the governing law of the 1935 and 1959 Plan is that of a Canadian common law jurisdiction.)

Section 4: Assets of the Pension Fund

4(a) What claims generally do pensioners and actives have to the assets of the Fund as an ongoing Fund?

Answer: Active employees are entitled to have their own contributions accumulated in the Fund, invested at an interest rate not lower than a prescribed rate (Rules 3(3) and 108), and to have their own contributions refunded in the circumstances and in the manner described in the Rules (see Index to Consolidated Rules of the 1959 and 1935 Pension Plans, Contributions — refunds of; Refunds).

Pensioners, that is to say, persons currently in receipt of a pension, do not have in my opinion any claim against the Fund. Their claims are to the formula pension for which they qualified under the Plan on retirement, plus such further sums as the employer at subsequent dates has obligated itself to pay to such persons. To the extent, however, that the employer validly asserts that it has discharged its obligation by funding the Plan, the pensioners as well as active employees do look to the Fund for pension payments.

Both active employees and those on pension are entitled to have CN fund the consolidated plans in accordance with Reg. 12 of the PBSA, and any requirements by the Superintendent further to that regulation and the Act.

The pensioner briefs appear to reveal a basic misconception of the nature of the two plans. In the document entitled, "Memorandum on the History of CN Pension Arrangements", the 1935 Plan is described as "a defined benefit plan with money purchase features", and the 1959 Plan is "a defined benefit plan". Since 1960 the 1935 Plan has been funded on an actuarial basis. The authors of the briefs argue (1) that excess earnings should be used to pay higher pensions, (2) that the employer should not use excess earnings to meet its unfunded liability, (3) that the employer is taking inflationary gains in order to meet that liability, (4) that the employer is required to meet deficiencies out of its own funds, (5) that interest payments to the Fund are shown as employer contributions because the Superintendent requires CN to report on principal payments and current service costs, but not on interest payments, and (6) that the interest rate assumption of 4% was retained long after market interest rates had gone considerably higher.

In my opinion these arguments, and the briefs' accompanying calculations, overlook the fact that a defined benefit plan obligates the employer to pay a pension to each qualifying employee based, not upon a fund, but upon a formula, whose constituents are salary paid over a described period of time, a multiplying factor, and years of service. The plan may also require the employer, following the employee's retirement, to index, either fully or partly, the annual pension paid. If a defined benefit plan is non-contributory, there really is no need of a fund, putting aside the PBSA for a moment, any more than a fund is needed when an employer has on-going wage obligations to an employee. The function of a fund in these circumstances is to protect the employee against the inability of the employer to pay the

pension when the time comes, or against the employer's bankruptcy or termination through take-over or merger. When the plan is contributory, however, a fund is necessary, because the employee is entitled to have his contributions held separately from the employers's assets, to have them invested so that they will produce a return, and to have them returned, usually together with interest, in the event that the employee leaves the service of the employer, or dies, prior to retirement age. Where the contributions of the employer will also be paid to the employee in the circumstances of resignation, termination or death, prior to the retirement age, a fund will also serve to protect this interest of the employee, though, again, a fund is not essential for this purpose. There can be a notional employer contribution, and an interest rate assumption, so that the obligation of the employer to the employee remains a personal one.

In the case of the CN plan, which is contributory, the role of the fund is essentially to protect the employee's contributions, to be a receptacle for the investment return, and to preserve these contributions plus interest for refund requirements. Active members have the right to make claim for their contributions, without interest or plus interest, in specified circumstances. Pensioners, having retired, will not have this right because their contributions plus the accumulated interest thereon are now providing pension payments. The employer is also obligated to make current service contributions and such further funding payments as the PBSA and the regulations thereto require for actuarial soundness. Active employees and pensioned employees are entitled to determine that these employer obligations are being met, but this is not of course a claim to any assets of the fund.

4(b) If the answer to question 3(e) (regarding CN'S claim to an experience surplus) was in the affirmative, and if it was based on provisions of the present *Pension Benefits Standards Act*, suppose the relevant provisions of that Act did not exist.

- (i) would there then be any basis in law for claiming that CN should have used the experience surplus for the beneficiaries of the Fund?
- (ii) would there then be any basis in law for claiming that CN should have used the surplus to improve pensions in pay, rather than pay down the unfunded liability, for example?

Answer: Essentially the question asks whether members, i.e., beneficiaries, of the Plan have any right to demand that surpluses in the Fund be used to pay added benefits to members, and therefore to prevent CN from using any part of those surpluses to meet its own liabilities under the terms of the Plan. I did answer question 3(e) in the affirmative, and I observed that, while an unpersuasive argument based on the PBSA could be mounted to the contrary, I saw nothing in the terms of the Plan to prevent CN using any surplus for the purpose of discharging its current service obligations.

The members, whether active or pensioned, are entitled under the Plan terms to a formula benefit plus such further enhancements as CN has obligated itself to provide. It follows from my last answer that, provided the Plan is actuarially sound, that is the sum total of the members' claim. The misconception of the Plan members is that the *fund* is theirs, as if the plan were a kind of money purchase plan, like an R.R.S.P. The CN Plan falls within (a) of the definition of "pension plan" in section 2 of the *Pension Benefits Standards Act*, not within (b), as the authors of the pension briefs appear to imagine. It is possible, even in a

money purchase plan, for a "surplus" to arise. This would happen, for instance, where the employer pays a greater contribution per member to the plan than he is obligated to do under the terms of the plan. It is difficult to see how such an error could occur, but, if it were to happen, the employer would be entitled to call for the return to him of the excess amounts plus an appropriate sum of investment return. If the stipulated employer contribution is 7% of gross monthly salary, and the employer pays in error 8%, the employer is entitled to recover 1% plus the investment return on 1% for the period of wrongful retention by the fund. The retention is wrongful because the benefit to which the member is entitled is 7% plus the investment return on the 7%.

In a defined benefit plan, surplus, like deficiency, can easily occur because of the number of variables in assessing from year to year what is required to meet actuarial soundness, and the necessary level of funding. But the rights of members are no greater when there is a surplus, for the same reason that they are no less when there is a deficiency. Pension benefits are today seen as a form of emolument from the employer. Prior to 1973 CN as employer determined the amount of that form of emolument, as it determined what employees themselves should contribute out of salary or wages. In 1973 and subsequent years pension benefits have been the subject of collective agreements between CN and the union, but the principle remains the same, namely, that once the amounts of benefit are determined that is the totality of the employees (and the pensioners') entitlement. Wage rates are settled, benefit amounts are settled, and there is an end of the matter, until a new collective agreement is entered into. The amount in the trust fund — beyond the amount of the members' own contributions plus the interest entitlement thereon, and any funding of the plan which the employer validly claims had discharged his obligation — $\frac{3}{4}$ is neither here nor there, so far as the members' claims against that fund is concerned.

The root of the pension briefs' concerns appears to be in large part, not only that the existing formula is considered to produce inadequate pensions, but that pensions under this Plan are not indexed. Not only pensioners, but active employees, realize the impact even an inflation rate of 4 – 5% p.a. will have upon pensions over an average retirement period (member and surviving spouse) of 10 – 20 years. Their fears are very understandable. Wages and salaries will reflect inflation, but once a member reaches retirement age, and his or her then career average monthly salary is used to determine the formula pension then payable, the decline of the purchasing power of that pension begins at the same time. The consequent apprehensions cause employees and pensioners to look at the *trusteed* character of the plan, and to assume fallaciously that that fund, whatever the source of its contents, is theirs. A misunderstanding of the function of interest rate assumptions, an investment power which largely leaves the Board of CN to determine what securities shall be selected for investment and in what "mix" as between debt and common shares (the 1935 Plan, Rule 108, appears to restrict severely the access to corporate shares and debt, unless government guaranteed), administration by CN of its own plan, and a misunderstood *Pension Benefits Standards Act*, have combined to fan the concerns and the sense of having been cheated.

The fact, however, is that the CN Plan is defined benefit, and there in my opinion the answer to this question stops. There is no basis in law known to me, in the absence of any contrary provision in the plan, for an argument that surpluses in the Plan cannot be employed by CN as the wherewithal to meet any funding obligations it has under the Plan.

4(c) If the Plan were fully funded — if there were no unfunded liability — and there were an experience surplus:

- (i) would CN be able to remove the surplus from the Fund?
- (ii) would CN be able otherwise to use the surplus for its benefit rather than for the benefit of the Fund beneficiaries?
- (iii) if the answers to (i) and (ii) depend on provisions of the present *Pension Benefits Standards Act*, suppose the relevant provisions of the Act did not exist; would the answers then be different?

Answer: 4(c)(i) Given the approval of the Superintendent under Regulation 11(4)(a) of the PBSA, and, assuming the correct interpretation of Rule 144(14) to be that it applies only to employer contributions under Rule 144 of the 1935 Plan for supplementary annuities (see now Rule 3(g)), it is my opinion that CN could remove from the Fund such proportion of the surplus as can be associated with employer contributions. The proportion of the total surplus associated on a ratio basis with employee contributions would be required to be left in the Fund for added employee benefits.

Comment — This question, 4(c), poses the most difficult of the questions to answer, because the law in this area has been the subject-matter of varying decisions in the courts, and the pension benefit Acts of the federal authority and of the provinces differ the one from another in their requirements. Having studied the Acts, the Canadian case authorities, both reported and, so far as known to me, unreported, together with eight of the leading U.S. judicial decisions, I would summarize the position, having in mind the CN Plan, in the following manner. In any jurisdiction it is necessary, in my opinion, first to examine what would be the answer under the case law. Then one refers to the pension benefits legislation, if any, to see whether and, if so, in what manner the case law result has been changed. Finally, one looks at the language of the plan in question — and I am assuming, of course, a defined benefit plan — to determine what answer, if any, the plan provides for such a surplus, and may be put into effect, given the pension benefits Act of the jurisdiction.

The question put to me assumes a surplus in an on-going plan situation, though under the case law a similar question arises when the surplus exists in a plan termination and wind-up situation.⁽¹⁾ A surplus can only be said to exist when a plan is actuarially fully funded, i.e., the fund is actuarially capable of meeting all the benefit liability to members.⁽²⁾ A defined benefit plan of the CN type requires active employees to contribute a percentage of wage or salary every prescribed period of time, which is then invested at an interest rate assumption, and the employer “tops up” in order to meet the formula benefit, with current service contributions plus further payments over prescribed periods of time so that he funds the liability for past service.

Under the case law of trusts a settlor is entitled to recover from the trust such funds as remain when the purposes of the trust have been met, and no provision is made in the trust instrument for what shall happen to these excess sums.⁽³⁾ This is the resulting trust which

⁽¹⁾ All the Canadian case decisions on the subject of surplus known to me have concerned surpluses in termination or wind-up situations.

⁽²⁾ *Van Orman v. American Insurance Co.*, 680 F. 2d 301, 305 (1982).

⁽³⁾ *Re Trusts of the Abbot Fund*, [1900] 2 Ch. 326.

arises by operation of law to return surplus funds to the only person who can make any claim to them, i.e., the settlor. The express trustee, being a trustee, cannot take the surplus for himself, and the beneficiaries or the purposes of the trust have fully acquired all the benefits intended by the express trust terms. Applied to a defined benefit pension plan this means that in the case of a non-contributory plan the employer is entitled to the whole of the surplus.⁽⁴⁾ When the plan is contributory on the part of the employees, the settlors are both the employer and the employees. Unless there is clear evidence that the surplus arises entirely from the employer's contributions, plus earnings, or the employees' contributions, plus earnings, the courts are likely to decide upon an equitable division which would reflect the ratio of employer to employee payments into the fund.⁽⁵⁾ In my opinion a ratio division would be adopted, were the case law to apply, in the case of the CN Plan. I assume it would be possible for the ratio to be calculated.

The question then arises of what PBSA requires. The PBSA requirements for dealing with the surpluses are in fact limited. The Act and its regulations are less comprehensive than, for instance, the Ontario Pension Benefits Act, and regulations thereto,⁽⁶⁾ and significantly less explicit than the Employee Retirement Income Security Act, 1974, in the United States.⁽⁷⁾ Regulation 11(4)(a) of the PBSA requires the approval of the Superintendent, before any funds can be paid out of a pension plan for the benefit of the employer, and in the absence of evidence available to me to the contrary I assume from the character of Regulation 13(3), to which Regulation 11(a) refers, that the Superintendent is merely concerned to see that by any repayment to an employer, the defined benefits of members are not put into jeopardy. However, whether such is his policy would have to be investigated. I have no information on this. I also observe from the C.B.A. paper on the Ontario Pension Benefits Act (p. 20) that jeopardy is the concern of the Ontario Pension Commission. For federal tax purposes National Revenue positively requires a refund to the contributing employer of any excess surplus, once the following two years of current service contributions have been provided for; the alternative is for the excess surplus to be retained to meet liabilities for past service or yet more distant future service. However, as I have earlier emphasized, it is important to note that this is for federal tax purposes only.

Finally, one turns to the CN Plan itself. Save for one circumstance, the Plan appears to me not to address the issue of the treatment of surpluses, either in an on-going situation, or on termination or wind-up of the plan.⁽⁸⁾ The one exception is Rule 144(14) which requires

⁽⁴⁾ *Canada Trust Co. v. Cantol Ltd.*, [1979] 6 W.W.R. 565; 103 D.L.R. (3d) 109 (B.C.). See also *Pollock v. Castrovinci*, 476 F. Supp. 604, 616 (1979).

⁽⁵⁾ *E.G., Martin & Robertson Administration Ltd. v. Pension Commission of Manitoba*, 21 February, 1980. Nitikman J.; Manitoba Q.B. The decision is noted at (1980), 2 A.C.W.S. (2nd) 249. In this case the plan actually specified an equitable division.

⁽⁶⁾ Cf., e.g., *King Seagrave Ltd. v. Can. Permanent Trust Co.* (1959), 51 O.R. (2d) 667.

⁽⁷⁾ See s. 4044(d)(1) of ERISA, 29 U.S.C., para. 1344(d)(1), and *Washington-Baltimore Newspaper Guild v. Washington Star Co.*, 555 R. Supp. 257, 259 (1983).

⁽⁸⁾ Most of the plans, where litigation has arisen, contain provisions as to what is to happen to a surplus on plan termination, and the construction issue which has been posed concerns the meaning and scope of these provisions. See, e.g., *Campbell v. Ferco Engineering Ltd.* (1984), 4 C.C.L.I. 268 (Ont.), and *Re Reeve and Montreal Trust Co.* (1984), 46 O.R. (2d) 667, both of which cases also involved the bona fides of the employer's exercise of its amendment power to obtain the surplus. CN has such an amendment power (see Rule 29 of the Consolidated Rules).

that a surplus of assets over liabilities, following the withdrawal by a terminating employee of his contributions (mandatorily without interest), shall remain in the Fund. In my opinion this sub-rule is applicable purely for the purposes of supplemental annuities under Rule 144, but this is a matter of construction, and it is possible that a court would give a wider applicability to it, though I doubt this in the light of Regulation 144(15).

My conclusion, therefore, is that, subject to the Superintendent's approval, and my interpretation of Reg. 144(14) being correct, CN is entitled to remove from the Plan part of any surplus which remains in the on-going plan after all benefits given by the Plan have been adequately funded. That part is to be determined on a ratio basis with employees' funding of the plan. Of course, such a ratio calculation assumes actual payments by CN, i.e., notional contributions or payments are not included. If the ratio cannot be agreed upon by CN and Plan members, the whole surplus would have to remain in the Fund.⁽⁹⁾

Answer: 4(c)(ii) In my opinion the only other way it would be possible for CN to use its share of the surplus for its own benefit, if it is not to remove that share from the Fund, is for it to leave its share in the Fund and use it to pay down future current service contributions (in fact MNR requires this to be done for the next 24 month period, as already discussed), or future unfunded liability arising on future ad hoc improvements to the benefits of members. I see no reason why this should not be done by CN under the case law, which I have discussed, or the PBSA which is silent on the point. After all, as I have concluded CN is entitled to remove a share of such a surplus for its purposes, it must follow that it can leave it in the Fund for its purposes.

Answer: 4(c)(iii) If the PBSA had not been enacted, my answers would be the same, save for the fact that no approval would be required from the Superintendent to the *removal* from the plan of the share of the surplus to which CN is entitled under the case law of resulting trust.

4(d) If the plan were fully funded — if there were no unfunded liability — and there were an experience surplus:

- (i) assuming that the surplus could not be ascribed entirely to CN contributions plus interest or employee's contributions plus interest, would Fund beneficiaries be able to remove their portion from the Fund, or demand that their portion be used immediately to benefit them, by increasing their benefits, for example?
- (ii) if the answer to (i) is in the affirmative, which of the following groups could make this claim: active employees, pensioners, survivors, estates of pensioners, any others?
- (iii) if the answer to (ii) involves more than one group, would each group share *pro rata* or in some other way?

Answer: 4(d)(i) In my answer to Question 4(c) I suggested that the most useful way in which to approach questions about surplus is to ask, first, what the case law provides; secondly, what the PBSA and its regulations provide; and thirdly, what the terms of the Plan

⁽⁹⁾ *Re Gillingham Bus Disaster Fund*, [1958] Ch. 62, [1958] 2 All E.R. 749.

in question provide. Applying that approach again, I would say that, if a surplus arises and the objects of the trust are already fully funded, there is a resulting trust in favour of the settlors. I.e., they are entitled to the return of the surplus. However, in this instance the Plan is assumed to be on-going when the surplus occurs, and, though this has not been the subject-matter of any decision known to me, it is arguable that a surplus can only be said truly to exist when the trust is at an end.⁽¹⁰⁾ It is not without significance that in the reported cases where the return of surplus was discussed, the plans in question were being terminated or wound-up. All the same, whatever the validity or invalidity of that argument, surplus can only be returned when the proportions to which each settlor is entitled can be calculated. The question put to me assumes this is not possible, so under the law of trusts the surplus would have to remain in the Plan.⁽¹¹⁾ Since the Plan is also assumed to be on-going when the surplus occurs, we need not canvass the question of what would happen to that surplus in the event of termination or wind-up. On the state of the authorities, the answer to that question is in any event only conjectural.

Does the PBSA and its regulations change this state of the law? The only reference in this context is Reg. 11(4)(b) which provides that no funds shall be paid out of a plan for the benefit of an employee, "except in accordance with the terms of the plan", unless the Superintendent approves. Assuming the plan in question is silent as to the entitlement of employees to any surplus, everything now turns on the Superintendent's exercise of his discretion. Some agreed mode of distribution of the surplus between the employer and the employees would presumably be necessary, but I have no knowledge of how the Superintendent would react to this or any other arrangement. He would certainly be concerned that the plan, here the CN Plan, is to continue beyond the time when moneys are so returned. This is not a termination. In summary, since the legislation and the regulations are effectively silent on surpluses and employees' contributions, the PBSA and its regulations only assist the situation through the discretion of the Superintendent.

Save for Reg. 144(14), which I have previously discussed and believe to be localised to a specific situation, the Plan here is silent on the subject of surpluses.

I conclude therefore that the surplus would have to remain in the Plan, and, since the Plan provides what benefits the members are to receive, the members are not entitled under the terms of the Plan to call upon the Trustee for increased benefits. The surplus is literally a surplus to the provision of stated benefits. Assuming that the source of the funds is not clearly determinable, as the Question does, the only solution I can see is that the employer and the members who have subscribed to this surplus come to some agreement — 50% and 50%? — that the surplus be applied to future contribution obligations of the employer (i.e., current service contributions) and of the members. If the period during which the surplus occurred includes contributing members who have since retired, but there is an agreement, the court might be willing to entertain an application under the governing Variation of Trusts Act, and consent on behalf of those former active members who cannot be traced, or whose estates have a claim.⁽¹²⁾ However, if an agreement cannot be reached, an application

⁽¹⁰⁾ This was the situation in *Re Trusts of the Abbott Fund*, supra, footnote 3.

⁽¹¹⁾ *Re Gillingham Bus Disaster Fund*, supra, footnote 9.

⁽¹²⁾ In *Re Sandwell & Co. Ltd. and Royal Trust Corp. of Canada* (1985), 17 D.L.R. (4th) 337 (B.C.C.A.), the origin of the surplus was conceded by all parties to be from the employer's contributions. However, if the amount of the surplus is known, and there is an agreement, the principle of this case is clearly on point.

would have to be made to the court under the governing provincial Trustee Act for advice and direction. In the absence of any precedent known to me on the subject, and the silence of the Plan on the subject, I cannot advise on what the outcome of that application is likely to be. Clearly, if the occurrence of the Question's assumed fact situation is at all likely, moves should be undertaken without delay to amend the Plan so that provision of some kind is made before the situation arises.

If the Question is to be read that, though the surplus cannot be ascribed entirely to CN's contributions or to the employees' contributions, but the proportions subscribed by each can be determined, it is my opinion that the members of the Plan who did contribute to the employees' portion of the surplus would only be able to recover their portion under Reg. 11(4) with the approval of the Superintendent. However, I would draw attention to Rule 11(2). They would claim, if claim to surplus survives Rule 11(2), as resulting trust beneficiaries further to the governing law of trusts. As I have earlier stated, I am not aware of how the Superintendent handles such applications to withdraw surpluses, but I would assume that he would be concerned that in this case no termination of the Plan is intended, and that all those who contributed to the surplus receive an appropriate share of the returned surplus. I do not see on what basis increased benefits could be paid to the contributing members, because the Plan is silent on what form those benefits might take. The Trustee can only act in accordance with the terms of the Plan as they are at the moment of the surplus occurring. If increased benefits are to be paid out of any surplus, it would be my opinion that an amendment to the Plan under Rule 29 would be necessary.

Answer: 4(d)(ii) If the proportions in which the CN and employees contributed to the surplus can be determined, so that a resulting trust is possible, then it is my opinion that all those who contributed as employees are entitled to an appropriate share. Where members have in the meantime retired, they are entitled as pensioners or through their qualified pensionable survivors or through their estates. If they have left the service of CN or died prior to retirement, such persons or their estates are entitled to the appropriate share. The principle of the resulting trust governs, namely, that every settlor of his estate is entitled to participate to the extent of his share for the purposes of any refunding.

Answer: 4(d)(iii) In my opinion a *pro rata* division, i.e., proportionate to the contribution of each group, is the only possible solution. The case of *Martin & Robertson Administration Ltd. v. The Pension Commission of Manitoba*, 21 February, 1980, *per* Nitikman J., could be an example of what I believe is an unreported case. A surplus occurring upon the termination of a plan, and the plan being silent as to how it should be handled, the trial judge noted: "The only feature [of the Plan] that stands out is that on discontinuance of the plan, the company shall inter alia wind up the plan in an equitable manner as further in the section is set out." He later concluded that, as "it was actuarially possible to make an estimate dividing the surplus between the employer and the employees in accordance with their respective contributions to the fund", he would make an order that the fund "be wound up on that basis and payments be made accordingly". There is no provision in the CN Plan requiring equitable distribution of surplus in either an on-going or a termination situation, but in my opinion that principle should and would be drawn upon in order to settle on a division of the surplus between contributing member groups.

Addendum

A question is raised in the document entitled, "Memorandum on the Administration of the CN Pension Plan", as to the documentation which constitutes the CN trustee pension plan. In my opinion the By-Law containing the Consolidated Rules of the 1935 and 1959 Plans, and By-Law No. 80 concerning the investment of funds by the Company in its capacity as Trustee, together constitute the Pension Plan. It is usual drafting practice for there to be a trust deed (apart from the plan) which creates the office of trustee, provides for the appointment and discharge of the trustees, and sets out their duties and powers, which includes the power of investment. The trustees determine their investment policy within the scope of the power given to them by this deed. It is widely considered undesirable to have any outside body or person with the power to determine policy for the trustee or trustees, especially when that body or person is the employer or, for that matter, the labour union. Under trust law it would be most undesirable if the trust is truly to be seen as an independent arrangement having as its sole purpose the benefit of all the members, namely, active employees, retired employees, and other pensioners, such as surviving spouses. See, e.g., *Cowan v. Scargill*, [1984] 2 All E.R. 750.

If it would be helpful for me to add a closing comment, I would reiterate my support of the recommendation that CN divorce itself from the role of trustee, and transfer this task to another who is independent of both employer and employees. At least, as an alternative, the trustees — with the usual plenary powers of such an office — should be drawn from both the employer and the employees, provided it is recognized by each such nominee that he or she sits as a trustee on behalf of all plan members, and not in any way as a mandatory of the Company or of the union. See *Cowan v. Scargill*, *supra*. I would also commend that after 40 years of the consolidated Plans, during which time the attitude of society towards the nature and role of pension plans and pension funds has so dramatically changed, the moment has come for the redrafting of the Plan. In my opinion much needs to be thought through afresh in the structure and administration both of the trusteeship and of the plan; the present Consolidated Rules are often repetitive, there are ambiguities in the relationship of the two sets of rules, and there are silences, for instance, on surpluses, where a contemporary plan would provide. There are also instances where the policies of the Plan should be considered. For example, no interest is paid on employee withdrawals (Rule 144(9)(a)); this is a provision which may be thought to ill-fit a generation which is striving for equity and portability. In short, in my opinion there is a good case for termination of the consolidated 1935 and 1959 Plans, and their replacement with a totally new Plan.

Whether benefits should be changed at all, or in any new Plan, is a matter for others to decide, but it may be that in the present climate of collective agreements over wages and benefits it might assist all sides if a study could be conducted on the advantages and fiscal possibilities of some indexing, in place of regular ad hoc increases.

(Signed)
D.W.M. Waters,
Barrister and Solicitor,
Professor of Law.

Details of a Scheme of Distribution of the Experience Gain with the Survivor Benefit Adjusted to 60% of the Retirement Benefit

The following calculations are based on a commencement date of January 1, 1987. However, the Sub-committee has recommended that the scheme start one year later, to allow union and management to negotiate indexation for employees retiring after that date.

The First Year of the Scheme — 1987

- **For each pensioner over age 65 who retired before January 1, 1986 calculate “the basic pension”**

The basic pension is the CN retirement pension paid in 1986 according to the 1935/1959 Plan rules, including all ad hocs granted and paid before January 1, 1987, to which is added any OAS allowance deductions made in 1986.

- **For each survivor who is over age 60, or whose spouse was receiving the supplement below, calculate “the basic adjusted pension”**

The basic adjusted pension is the sum of:

- (i) the CN survivor pension paid in 1986, including all ad hocs granted and paid before January 1, 1987 (for survivors whose spouses died in 1986, assume the spouse died prior to January 1, 1986)

AND

- (ii) an adjustment equal to 20% of the amount in (i) made to implement the 60% survivor benefit.

- **To the basic pension and the basic adjusted pension add**

- (i) a supplement equal to 1/12 of 2% multiplied by the number of whole months from the date the pensioner (or the spouse of the survivor) retired to January 1, 1967; plus 1/12 of 2%, reduced by 0.1% each year, multiplied by the number of whole months in each year between 1967 and 1976; plus 1/12 of 1% for the months after January 1, 1977 to January 1, 1987

AND

- (ii) a supplement equal to 50% of the increase in CPI since January 1, 1986 multiplied by the basic pension or the basic adjusted pension, to a maximum increase of 2%

- **The resulting amount may not exceed 50% of the YMPE for 1986 (\$12,900)**

The Second and Subsequent Years of the Scheme

- **Calculate the basic pension**

This calculation is based on the 1987 (and subsequent years) CN retirement pension and is as described in the scheme for the first year, making the necessary changes in dates.

- **Calculate the basic adjusted pension**

This calculation is based on the 1987 (and subsequent years) CN survivor pension and is as described in paragraph (i) of the scheme for the first year, with the necessary changes in dates. Because the 1987 (and subsequent years) CN survivor pension will reflect the 20% increase there will be no need for the additional adjustment described in paragraph (ii).

- **To the basic pension and the basic adjusted pension add**

- (i) a supplement equal to 1/12 of 2% multiplied by the number of whole months from the date the pensioner (or the spouse of the survivor) retired to January 1, 1967; plus 1/12 of 2%, reduced by 0.1% each year, multiplied by the number of whole months in each year between 1967 and 1976; plus 1/12 of 1% for the months after January 1, 1977 to January 1, 1987

AND

- (ii) a supplement equal to the lesser of:

A. 50% of the increase in CPI since the pensioner (survivor) became eligible to receive a supplement

and

B. 2% compounded by number of years the pensioner (survivor) has been eligible to receive a supplement

multiplied by the basic pension or the basic adjusted pension.

- **The resulting amount may not exceed \$12,900 increased by 2% for each year the scheme operates**

The following aspects of the calculation — especially the limitations or “caps” — should be noted:

- (1) for a pensioner, supplements do not start until age 65; for a survivor not until age 60 unless the deceased spouse was receiving the supplements;
- (2) for a pensioner who retires at age 65, part of the first year of retirement is excluded;
- (3) those retiring before age 65 do not receive any supplement until *after* they reach age 65;
- (4) the effect of OAS bridging is eliminated in the calculation of the supplement;
- (5) supplement (i) applies only to retirement years (expressed in months) before January 1, 1987 and will remain the same throughout time;
- (6) supplement (ii) — the inflation supplement — is cumulative, with a cap of 2% multiplied by the number of years between eligibility and the year the calculation is done. The supplement will grow;
- (7) the total supplement — the amount of supplements (i) + (ii) — is capped to 50% of the 1986 YMPE. This cap will rise by 2% per year.

We stress that the formula described above must be tested by comparing the sum of the total supplement for each pensioner and survivor with the amount of the experience gain available. We consider the formula to be a maximum; if the experience gain is smaller than the sum of the total supplements, the formula must be adjusted. We strongly urge that in making an adjustment every effort be made not to reduce the amount of the previous years' supplement. Other measures which could be considered instead include, but are not limited to, the following:

- eliminating the automatic 2% increase of the YMPE cap, so that the cap becomes a constant;
- reducing the percentage of the increase in CPI from 50% to some lower number.
- increasing the waiting time between the date of retirement and the initial receipt of the supplements, e.g. age 66 instead of 65;

APPENDIX "B" APPLIED TO PENSION BENEFITS ESTIMATED TO BE RECEIVED IN 1985 BY AVERAGE LONG-SERVICE PENSIONER*

1	2	3	4	5	6	7	8	9	10	11	12	13	14
Supplements (i)+(ii)													
Year retired	CN Pension at Retirement	CN Pension in 1985	50% CPI in 1985 (2% cap)	2/1% × Years retired to 1985	Total Supplemented CN Pension	% increase	1985 OAS (273.80 × 12) Single	1985 C/QPP	Total pension income received single	1985 OAS (spouse)	Total Pension Couple	Couples' pension if un-supplemented	% increase
1960	2,273.64	4,881.36	97.62	1,781.68	6,760.66	38.4	3,285.60	—	10,046.26	3,285.60	13,331.86	11,452.56	16.4
1961	2,322.12	4,894.32	97.89	1,688.53	6,680.74	36.4	3,285.60	—	9,966.34	3,285.60	13,251.94	11,465.52	15.5
1962	2,531.28	5,110.80	102.21	1,684.56	6,872.02	34.4	3,285.60	—	10,157.62	3,285.60	13,433.22	11,682.00	15.0
1963	2,909.76	5,530.92	110.61	1,659.00	7,328.45	32.4	3,285.60	—	10,614.05	3,285.60	13,899.65	12,102.12	14.8
1964	2,795.76	5,325.84	106.51	1,517.85	6,950.20	30.4	3,285.60	—	10,235.80	3,285.60	13,521.40	11,897.04	13.6
1965	3,289.32	5,863.20	117.26	1,553.73	7,557.64	28.8	3,285.60	—	10,843.24	3,285.60	14,128.84	12,434.44	13.6
1966	3,698.40	6,278.04	125.56	1,538.05	7,941.65	26.4	3,285.60	—	11,227.25	3,285.60	14,512.85	12,849.24	12.9
1967	3,494.28	5,957.64	119.15	1,340.46	7,417.25	24.4	3,285.60	403.32	11,106.17	3,285.60	14,391.77	12,932.16	11.2
1968	3,640.44	5,885.76	117.71	1,212.46	7,215.93	22.6	3,285.60	795.60	11,297.13	3,285.60	14,582.73	13,252.56	10.0
1969	4,272.60	6,360.12	127.20	1,195.69	7,683.01	20.7	3,285.60	1,185.96	12,154.17	3,285.60	15,440.17	14,117.28	9.3
1970	3,857.64	5,646.72	112.93	965.48	6,725.23	19.0	3,285.60	1,580.28	11,591.11	3,285.60	14,876.71	13,798.20	7.8
1971	5,042.16	6,683.88	133.67	1,036.00	7,853.55	17.4	3,285.60	1,974.00	13,113.15	3,285.60	16,398.75	15,229.08	7.6
1972	5,762.88	7,178.88	143.57	1,005.04	8,327.49	16.0	3,285.60	2,366.16	13,979.25	3,285.60	17,264.85	16,116.14	7.1
1973	6,430.80	7,233.48	144.66	911.41	8,289.55	14.6	3,285.60	2,700.96	14,276.11	3,285.60	17,561.71	16,505.64	6.3
1974	6,571.68	6,994.08	139.88	790.32	7,924.28	13.2	3,285.60	3,060.60	14,270.48	3,285.60	17,556.08	16,625.88	5.6
1975	8,084.28	8,254.68	165.09	833.72	9,253.49	12.0	3,285.60	3,452.04	15,991.13	3,285.60	19,276.73	18,277.92	5.4
1976	8,773.56	8,773.56	175.47	789.62	9,738.65	11.0	3,285.60	3,926.04	16,950.29	3,285.60	20,235.89	19,270.80	5.0
1977	9,371.64	9,371.64	187.43	749.73	10,308.80	9.9	3,285.60	4,067.76	17,662.16	3,285.60	20,947.76	20,010.60	4.7
1978	10,222.20	10,222.20	204.44	715.55	11,142.19	8.9	3,285.60	4,237.80	18,665.59	3,285.60	21,951.19	21,031.20	4.4
1979	11,253.39	11,253.39	225.06	675.20	12,153.65	7.9	3,285.60	4,360.08	19,799.33	3,285.60	23,084.93	22,184.67	4.0
1980	11,414.64	11,414.64	228.29	570.73	12,213.66	6.9	3,285.60	4,484.16	19,983.42	3,285.60	23,269.02	22,470.00	3.5
1981	11,809.68	11,809.68	236.19	472.38	12,518.25	5.9	3,285.60	4,578.36	20,382.21	3,285.60	23,667.81	22,959.24	3.0
1982	14,613.12	14,613.12	** (292.26)	** (438.39)	14,613.12	—	3,285.60	4,373.08	22,471.80	3,285.60	25,757.40	25,757.40	—
1983	16,288.56	16,288.56	** (325.77)	** (325.77)	16,288.56	—	3,285.60	4,613.76	24,187.92	3,285.60	27,473.52	27,473.52	—
1984	17,015.64	17,015.64	** (340.31)	** (170.15)	17,015.64	—	3,285.60	4,854.60	25,155.84	3,285.60	28,441.44	28,441.44	—

* These amounts are equal to the average benefit received by employees who worked for 35 years or more. The calculations cannot be taken as fixed amounts which will actually be given to pensioners once the Sub-committee's recommendations are implemented. Pensioners may receive benefits over or under the average. Also it may be necessary to adjust these calculations, depending on amounts of experience gain available.

** CN Pension exceeds maximum of \$12,900.

APPENDIX C

Witnesses

NAME	ISSUE	DATE
Abbott, Lloyd K. , Moncton, New Brunswick	6	October 22, 1985
Andrew, Paul , Vancouver, British Columbia	4	October 15, 1985
Ashcroft, Gordon , Winnipeg, Manitoba	5	October 17, 1985
Bédard, Henri , Vaudreuil, Quebec	8	October 31, 1985
Biggar Railway Employees' and Pensioners' Association:	7	October 29, 1985
—H.K. Beckett, Chairman;		
—W.A. Robbins, former Minister of Finance and Revenue, Saskatchewan		
Black, Tom A. , Brandon, Manitoba	5	October 17, 1985
Brasher, John R. , Swan River, Manitoba	5	October 17, 1985
Brotherhood Railway Carmen of the United States and Canada:	6	October 22, 1985
—Gregory Murphy, President;		
—Peter Roy, Canadian Vice-President		
Campbell, Harold N. , London, Ontario	2	October 3, 1985
Canadian National Railways:	1	October 2, 1985/
—Jean-Pierre Laroche, Vice-President, Employee Relations;	12	December 19, 1985
—Yvon H. Masse, Senior Vice-President and Chief Financial Officer;		

NAME	ISSUE	DATE
—Bernard Morency, Principal, “William Mercer Limitée”;		
—George Lach, Pensioner, Former Senior Vice-President;		
—Edmond D. Pinsonnault, Vice-President and Counsel;		
—Tullio Cedraschi, President, CN Investments;		
—Robert Zuban, Manager, CN Pensions Administration		
Canadian Pacific Limited:	10	December 17, 1985
—R.T. Riley, Vice-President Corporate;		
—J.-L. Massé, Actuary and General Manager, Pensions CP Rail;		
—R. Granger, General Manager, Personnel CP Rail		
Canadian Pacific Pioneers’ Association:	4	October 15, 1985
—James G. Chester, Secretary		
Canadian Railways Employees’ Pension Association:	4	October 15, 1985/
—J. Earl White, National President;	12	December 19, 1985
—James G. Chester, Vice-Chairman, British Columbia Branch;		
—Maurice H. Farrant, Actuary		
Canadian Railways Employees’ Pension Association — Moncton Branch:	6	October 22, 1985
—J.E. Cormier, President		
Canadian Railway Labour Association:	2	October 3, 1985
—Edward G. Abbot, Executive Secretary		
Capri, Michael, Winnipeg, Manitoba	5	October 17, 1985
Chiasson, Robert, Riverview, New Brunswick	6	October 22, 1985
CN Pensioners’ Association — Kamloops Local:	4	October 15, 1985
—Jack Brooks, President;		
—Tom W. Giles, Member		
CN Pensioners’ Association — Council #1, Moncton:	6	October 22, 1985
—E.E. Saulnier, President;		
—Hugh Reardon, Secretary-Treasurer of Atlantic Region Council of CN Pensioners’ Association		
CN Pensioners’ Association — Montreal Local	3	October 8, 1985
—Patrick Noël, President		
CN Pensioners’ Association — Provincial Local, Province of Quebec:	2	October 3, 1985
—Paul H. Gignac, President		

DATE	NAME	ISSUE	DATE
	CN Pensioners' Association — Quebec Local: —Charles Davis, President; —Marius Pelletier; —Fernand Mercier	3	October 10, 1985
	CNR Disability Pension: —Michael McCrosson	7	October 29, 1985
	CNR Lady Pensioners' Association: —Carlyne E. Buck, President	7	October 29, 1985
	Coates, James. A. , Greenfield Park, Quebec	7	October 29, 1985
	Crass, Emil , Winnipeg, Manitoba	5	October 17, 1985
	Daly, Owen P. , Moncton, New Brunswick	6	October 22, 1985
	Doyle, James , Moncton, New Brunswick	6	October 22, 1985
	Edgar, George Maxwell , Vancouver, British Columbia	4	October 15, 1985
	Employees' and Pensioners' Association on Inflation Compensation: —Arthur J. Campbell, Organizer	4 8 12	October 15, 1985/ October 31, 1985/ December 19, 1985
	Fraser, L. Michael , St. Albert, Alberta	4	October 15, 1985
	Government of the Province of Manitoba: —Al Mackling, Minister of Labour; —W.A. (Wes) Peters, Superintendent of Pensions, Manitoba Pension Commission	5	October 17, 1985
	Hansen, Heinz , Kamloops, British Columbia	4	October 15, 1985
	Horbulyk, Mike , Burnaby, British Columbia	4	October 15, 1985
	Houlihan, Ella A. , Halifax, Nova Scotia	6	October 22, 1985
	International Association of Machinists and Aerospace Workers: —Hugh Mawhinney, General Chairman, District Lodge No. 2	5	October 17, 1985
	International Brotherhood of Electrical Workers — Local Union 409: —Boyd G. Kramble, General Chairman, Prairie and Mountain Regions, System Council #33; —George Woods, President; —Vic Clements, retired member	5	October 17, 1985
	International Brotherhood of Electrical Workers — Local Union 1574: —Roland Boone, Business Manager	4	October 15, 1985

NAME	ISSUE	DATE
Janega, Matthew , Dartmouth, Nova Scotia	6	October 22, 1985
Killick, Del for C.B. Morgan , Melville, Saskatchewan	5	October 17, 1985
Kohut, William , Winnipeg, Manitoba	5	October 17, 1985
Levangie, Augustus T. , Heatherton, Nova Scotia	6	October 22, 1985
Malashewski, Fred , Winnipeg, Manitoba	5	October 17, 1985
Manitoba Legislative Assembly: —Don Scott, M.L.A., Inkster	5	October 17, 1985
McDougall, Dave E. , Dugald, Manitoba	5	October 17, 1985
McKay, David , Port Coquitlam, British Columbia	4	October 15, 1985
McPhearson, B.A.D. , Moncton, New Brunswick	6	October 22, 1985
Mitten, Audber , Salisbury, New Brunswick	6	October 22, 1985
Montpetit, Jean-Guy , Montreal, Quebec	2	October 3, 1985
Moore, Leslie S.G. , Sidney, British Columbia	4	October 15, 1985
Moore, Raphael G. , Montreal, Quebec	2	October 3, 1985
Munro, Byron , Moncton, New Brunswick	6	October 22, 1985
National Advisory Council on Aging: —André Leblanc, Executive Director; —Yvette Brunet, Member	8	October 31, 1985
National Council of CN Pensioners' Associations Inc.: —George P. Bouchey, President; —Keith E. Hunt, Director; —J.W.G. MacDougall, Director; —Frank E. King, Executive Secretary; —Douglas Fullerton, Consultant	9	November 1, 1985
New Brunswick Senior Citizens' Federation Inc.: —Bernard Richard, Executive Director; —Edna Bourque, President; —Earl Wilson, Vice-President	6	October 22, 1985
O'Connor, John , Montreal, Quebec	7	October 29, 1985
Ottawa Retired Railway Pension Association: —J. Rod Cameron, Vice-President	8	October 31, 1985
Phillips, George , Winnipeg, Manitoba	5	October 17, 1985
Richens, Frank E. , Ottawa, Ontario	7	October 29, 1985
Saskatchewan CPR Pioneers Social and Service Association: —Vic Myers, President; —Mildred Little, Secretary-Treasurer	3	October 10, 1985

NAME	ISSUE	DATE
Scaletta, Sebastian , Winnipeg, Manitoba	5	October 17, 1985
Taylor, Ted , Smithers, British Columbia	4	October 15, 1985
Thompson, Gordon , Winnipeg, Manitoba	5	October 17, 1985
United Transportation Union — Local 353 London: —Peter Maslak, Legislation Representative	8	October 31, 1985
United Transportation Union — Local 1874: —Gil E. Blais, Pension Committee Representative	5	October 17, 1985
Vance, Webb , Moncton, New Brunswick	6	October 22, 1985
Warmerdam, Bert , Smithers, British Columbia	4	October 15, 1985
The Wyatt Company: —Bruce I. Rollick, Vice-President and Director; —Maurice H. Farrant, Actuary	11	December 17, 1985
Wynes, James W. , Dauphin, Manitoba	5	October 17, 1985

Submissions

NOTA: The Sub-committee received written material (letters, reports, briefs or articles) from the following groups and individuals:

NAME

-
- Atkin, R.**, Kelowna, British Columbia
- Bicknell, A.L.**, Woodstock, Ontario
- Boyer, Albert A.**, Foleyet, Ontario
- Brenie, Brian W.**, Montreal, Quebec
- Brotherhood Railway Carmen Workers** — Lodge #420:
—John A. Merritt, President
- Buell, Jack W.**, Brockville, Ontario
- Campbell, G.J.**, Belleville, Ontario
- Caron, Roland**, Montreal, Quebec
- Chamberland, Thomas**, Boucherville, Quebec
- Clayton, Gordon B.**, North Bay, Ontario
- CN Pensioners' Association**—Belleville Local:
—S. Woodward, Secretary
- CN Pensioners' Association** — Edmundston Local #3:
—Oneil McDonald, President
- CN Pensioners' Association** — London Local:
—G.M. Lucy, Secretary

CN Pensioners' Association — Prince George and District:

—Gil Lindelauf, Secretary

CN Pensioners' Association — Stratford Local:

—Gordon E. Beadle, Secretary

CN Pensioners' Association — Toronto Local:

—D.F. Mills, President

Danylyk, Jim, Kitchener, Ontario

Desormeau, Ernest L., Cochrane, Ontario

Desrosiers, Jules, Lemoine, Quebec

Doogan, Esther, Belleville, Ontario

Duffy, John F., Verdun, Quebec

Ferguson, John R., Sydney, Nova Scotia

Gagnon, Cecil W., Winnipeg, Manitoba

Gajerski, Peter P., Winnipeg, Manitoba

Gallipo, O.A., North Bay, Ontario

Grégoire, Roger, Montreal, Quebec

Hodson, W.M., Dawson Creek, British Columbia

Hunter, H.C., Grand Falls, Newfoundland

International Association of Machinists and Aerospace Workers

Canadian Airways Lodge 764:

—W.J. Farrall, Pension Representative and General Chairman

International Brotherhood of Electrical Workers

System Council Number 33:

—Frank Klamph, System Council Chairman

Johnson, M.P., St. Williams, Ontario

Jones, J.T., Moncton, New Brunswick

Kaufman, Edward D., Dunneville, Ontario

Lacey, (Mrs.) Cyril E.P., London, Ontario

Lacombe, D.V., Moncton, New Brunswick

Lafferriere, T.O., Powassan, Ontario

Lane, John A., Fort Erie, Ontario

Lavoie, Vincent, St-Hubert, Quebec

NAME

- Leboeuf, Gérard, Longueuil, Quebec
 Leger, Yvon D., Cocagne, New Brunswick
 Lutes, Rupert E., Campbellton, New Brunswick
 Lyseyko, Harry, Grand Centre, Alberta
 MacDonald, John A., Halifax, Nova Scotia
 Mack, Norman, London, Ontario
 Maclean, C.G., Aldergrove, British Columbia
 McDougall, J. Lorne, Kingston, Ontario
 McNutt, Lorne P., Truro, Nova Scotia
 Medford, K.A., Delta, British Columbia
Members of the I.A.M. Lodge 1252, CNR Diesel Shop Concord, Ontario
 Miniely, Gordon W., Winnipeg, Manitoba
 Moran, E.J., Brockville, Ontario
 Morton, (Mrs.) W.R., Linden, Alberta
 Nadeau, Médard T., Baker Lake, New Brunswick
 Nichol, A., Nanoose Bay, British Columbia
 Nicolson, James S., Victoria, British Columbia
 Picard, (Mrs.) L.J., Edmundston, New Brunswick
 Raymond, Maurice, Drummondville, Quebec
 Rodgers, M.M., Shawnigan Lake, British Columbia
 Rowell, A.I., Sarnia, Ontario
 Roy, Garnet, Atholville, New Brunswick
 Salisbury, E.L., Niagara Falls, Ontario
Senior Citizens' Federation of Quebec:
 —Rose-Aimée J. Leblanc, President
 Shinkaruk, Nick, Edmonton, Alberta
 Skinner, Donald L., Louisbourg, Nova Scotia
 Smith, (Mrs.) W. Ken, Riverview, New Brunswick
 Sprague, Ivan, Toronto, Ontario
 Staines, H.L., Westbank, British Columbia
 Steeves, L.H., Riverview, New Brunswick

NAME

- Stewart, R.**, Blue River, British Columbia
Theriault, J.R., St. Basile, New Brunswick
Tobin, Nancy, Delta, British Columbia
Trickey, L.J., Toronto, Ontario
Walmsley, C.W., Dauphin, Manitoba
Webb, William D., Thunder Bay, Ontario
Yrjola, Wilfred, Roxboro, Quebec

Sub-committee Staff

CENTRAL TEAM

Administration

from the Committees and Private Legislation Directorate:

Diane Tremblay-Bernier, Clerk of the Sub-committee
Jean-Michel Roy, Clerk Assistant
Isabelle Des Chênes, Secretary
Rita-Marie Blais, Travel Co-ordinator

Research

from R. David Radford and Associates:

R. David Radford, Study Director

from the Research Branch of the Library of Parliament:

Mildred J. Morton, Legal Counsel and Research Associate

from Eckler Partners Limited:

David R. Brown, Actuary

from The Wyatt Company:

Maurice H. Farrant, Actuary

Legal Adviser

Donovan W.M. Waters, Professor of Law

Consultant

Hart D. Clark

Translation Bureau, Secretary of State

Cécile Fortier-Génier, Translator
Louis-Claude Leahey, Proofreader

Report Editing

Christiane E. Kaisin, Translating and Editing Inc.

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from the Research Branch of the House of Parliament
Mildred J. Morin, Legal Counsel and Research Associate
from Esther Lefebvre Lefebvre
David R. Brown, Actuary
from The Wyatt Company
Maurice H. Poirier, Actuary

A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 1 to 13 inclusive of the Sub-committee and Issue No. 49 of the Standing Committee, which contains this report*) is tabled.

Respectfully submitted,

Vince Dantzer
Chairman of the Sub-committee

Pat Nowlan
Chairman of the Standing Committee

MINUTES OF PROCEEDINGS

TUESDAY, MARCH 25, 1986
(66)

The Standing Committee on Transport met at 3:32 o'clock p.m. this day, for the purpose of organization.

Members of the Committee present: Iain Angus, Darryl L. Gray, Patrick Nowlan, Joe Reid, Fernand Robichaud and Gordon Taylor.

Other Members present: Bill Gottselig, George Henderson and Morrissey Johnson.

In Attendance: From the Library of Parliament: John Christopher, Research Officer.

The Clerk of the Committee presided over the election of the Chairman.

On motion of Mr. Gordon Taylor, Pat Nowlan was elected Chairman of the Committee.

Pat Nowlan took the Chair as Chairman of the Committee.

On motion of Mr. Gordon Taylor, Darryl L. Gray was elected Vice-Chairman of the Committee.

Mr. Iain Angus moved, — That the Chairman, the Vice-Chairman and three (3) other Members appointed by the Chairman after the usual consultations with the Whips of the different parties, do compose the Sub-Committee on Agenda and Procedure.

After debate the question being put on the motion it was agreed to.

On motion of Mr. Fernand Robichaud, it was agreed, — That the Committee print one thousand (1,000) copies of its Minutes of Proceedings and Evidence.

On motion of Mr. Iain Angus, it was agreed, — That the Chairman be authorized to hold meetings to receive and authorize the printing of evidence when a quorum is not present providing that four (4) members, one (1) of whom must be the Chairman or Vice-Chairman are present.

At 3:50 o'clock p.m. the Committee adjourned to the call of the Chair.

Nino A. Travella
Clerk of the Committee

THURSDAY, APRIL 10, 1986
(67)

The Standing Committee on Transport met *in camera* at 3:30 o'clock p.m. this day, the Chairman, Patrick Nowlan, presiding.

Members of the Committee present: Iain Angus, Les Benjamin, Terry Clifford, Dennis H. Cochrane, Vincent Dantzer, Darryl L. Gray, Patrick Nowlan, Joe Reid, Gordon Taylor and Brian Tobin.

Acting Member present: Maurice Foster.

In attendance: From the Library of Parliament: John Christopher, Research Officer.

The Committee proceeded to consider its future business.

It was agreed, — That a Sub-Committee of five (5) members be constituted to study the St. Lawrence Seaway Authority.

It was agreed, — That the Committee travel to Winnipeg, Churchill, Rankin Inlet, Resolute, Yellowknife, Inuvik, Whitehorse and Vancouver from May 7 to May 16, 1986 to study the adequacy of transport services in the Western Arctic.

It was unanimously agreed — That the Committee invite representatives of the National Capital Commission to appear on Thursday, April 17, 1986 at 9:30 o'clock a.m. and 3:30 o'clock p.m. to consider the subject matter of the effect of the possible future site of the American Embassy on the Rockcliffe Airport.

Mr. Dantzer from the Sub-Committee tabled the Sixth and Final Report of the Sub-Committee on the CNR Pension System.

It was agreed, — That the Committee will consider the report after all members have had a chance to read it.

At 5:15 o'clock p.m. the Committee adjourned to the call of the Chair.

Nino A. Travella
Clerk of the Committee

TUESDAY, APRIL 15, 1986
(68)

The Standing Committee on Transport met *in camera* at 3:30 o'clock p.m. this day, the Chairman, Patrick Nowlan, presiding.

Members of the Committee present: Iain Angus, Les Benjamin, Dennis H. Cochrane, Vincent Dantzer, Patrick Nowlan, Joe Reid, Fernand Robichaud and Gordon Taylor.

Acting Member present: Elliot Hardey.

In attendance: From the Library of Parliament: John Christopher, Research Officer.

The Committee proceeded to consider its future business.

Mr. Vincent Dantzer moved, — That the Committee approve a budget of \$776,887.00 which includes a budget of \$242,860.00 for the Sub-committee on the St. Lawrence Seaway Authority plus a budget of \$534,027.00 for the Standing Committee on Transport for the period from April 1st, 1986 to March 31, 1987; and that the Chairman be instructed to present the said budget to the Liaison Committee.

After debate, the question being put on the motion it was agreed to.

It was agreed, — That the Committee meet as follows:

April 22nd — 9:30 a.m. and 3:30 p.m.: Sub-committee report on CNR Pensions.
(*In camera*)

April 22nd — 7:30 p.m.: Minister of Transport.
Main estimates 1986-87.

April 24th — 9:30 a.m.: Officials on Airport Security.

April 29th — 9:30 a.m.: Senior Officials.
Briefing on Northern Transport.

May 22nd — 9:30 a.m.: Jean Pigott,
Chairman of the National Capital Commission
regarding Rockcliffe Airport.

At 4:50 o'clock p.m. the Committee adjourned to the call of the Chair.

Nino A. Travella
Clerk of the Committee

TUESDAY, APRIL 22, 1986
(69)

The Standing Committee on Transport met *in camera* at 9:30 o'clock a.m. this day, the Chairman, Patrick Nowlan, presiding.

Members of the Committee present: Les Benjamin, Terry Clifford, Dennis H. Cochrane, Vincent Dantzer, Darryl L. Gray, Patrick Nowlan, Joe Reid and Gordon Taylor.

In attendance: From the Library of Parliament: John Christopher, Research Officer.

It was agreed, — That the Sub-committee on the St. Lawrence Seaway Authority be composed of the following members: Iain Angus, Terry Clifford, Darryl L. Gray, Joe Reid and Fernand Robichaud.

The Committee resumed consideration of the Sub-committee's report on the Canadian National Railways Pension System.

On motion of Darryl L. Gray, the Sixth Report as amended of the Sub-committee on the Canadian National Railways Pension was concurred in.

It was agreed, — That the Committee print 1,000 copies of the English version of the report and 500 copies of the French version with a special cover.

ORDERED, — That Vincent Dantzer, for the Chairman, table the report, in the House of Commons, as the Seventh Report of the Standing Committee on Transport.

At 11:05 o'clock a.m. the Committee adjourned to the call of the Chair.

Nino A. Travella
Clerk of the Committee

EVIDENCE

Tuesday, March 25, 1986

• 1537

The Clerk of the Committee: Honourable members, you have your quorum.

The first item of business is the election of a chairman. I am ready to receive motions to that effect.

Mr. Taylor.

Mr. Taylor: I would like to move that Pat Nowlan be the chairman.

Motion agreed to.

The Clerk: I invite Mr. Nowlan to take the Chair.

The Chairman: Colleagues, I want to thank you very much for your confidence. I will not make any more of a speech, because we do things expeditiously in Transport, as was proven last year when we broke new ground. We are under new rules, so there is some new ground. I am glad to see a lot of good, familiar faces here. So without further ado, the Chair is prepared, and wants, to accept a motion for the election of a vice-chairman.

Mr. Taylor.

Mr. Taylor: I would like to move, Mr. Chairman, that Darryl Gray be the vice-chairman.

Motion agreed to.

The Chairman: I declare Mr. Darryl Gray—

Je déclare M. Darryl Gray dûment élu vice-président de ce Comité.

M. Gray: (Bonaventure—Îles-de-la-Madeleine): Merci beaucoup, monsieur le président. Je voudrais aussi remercier mes collègues pour la confiance qu'ils veulent bien m'accorder. Merci beaucoup.

The Chairman: The next item of business is the appointment of a subcommittee, and gentlemen, I am anxious to get this thing launched, that in view of the unknown days ahead the subcommittee, in the usual way, can plan some of the work of the standing committee in this new work environment. There are several matters some of us are aware of already, and that is why the subcommittee wants to meet.

I would like a motion that the chairman, the vice-chairman, and three other members appointed by the chairman, after the usual consultations with the Whips of the different parties, do compose the Subcommittee on Agenda and Procedure.

Mr. Angus: I so move.

Mr. Robichaud. I second the motion.

Motion agreed to.

The Chairman: It has been traditional in the past that 1,000 copies of the minutes are printed. If there is something unusual, that can always be changed. May I have a motion to that effect?

Mr. Henderson: I so move.

Mr. Angus: I second the motion.

Motion agreed to.

• 1540

The Chairman: The next usual motion is that the chairman be authorized to hold meetings to receive and authorize the printing of evidence when a quorum is not present, providing that four members, one of whom must be the chairman or vice-chairman, are present. That was the motion we had last time in terms of hearing evidence, and it really is to the benefit of all. It means that you can hear evidence without necessarily holding up witnesses who have come from afar if opposition members, who have many bases to cover, cannot get here. Once the voting comes, you must have a full quorum.

Mr. Angus:

Mr. Angus: I will move that motion, Mr. Chairman.

The Chairman: Thank you very much, Mr. Angus. I am glad the experience has been a great educator.

It is moved by Mr. Angus and seconded by Mr. Taylor. Agreed?

Motion agreed to.

The Chairman: Mr. Reid is here. Now, this is where the steering—

Mr. Reid: I was going to ask a question, but maybe you are going to lead to it, Mr. Chairman.

The Chairman: I was going to consider it, because I know we have talked about it and it has been in the public domain that this standing committee strike a subcommittee to study the St. Lawrence Seaway.

Mr. Reid: Mr. Chairman, I was wondering whether you could bring us up to date as to the earlier proposed establishment of what might be deemed a subcommittee of this committee to study the great benefits and adverse conditions of the St. Lawrence Seaway. I do not know whether this is something that falls into the domain of the steering committee or not, but I think perhaps not. I think perhaps it is going to be a question of consideration by a higher authority.

It is rather important, Mr. Chairman, and I would hope that, one, you can bring us up to date, and two, in a favourable manner.

The Chairman: Mr. Gray.

Mr. Gray (Bonaventure—Îles-de-la-Madeleine): May I make a suggestion, Mr. Chairman, because we are restrained for time this afternoon, that we hold a steering

committee meeting and if all members present here are willing to sit on it, in agreement with the opposition parties, that the subcommittee be struck for the St. Lawrence Seaway? And I believe that later on there is a possibility of a northern committee. If we could decide that in the steering committee and then bring it back to the full transport committee—

The Chairman: We have to bring back anything to the full committee. The St. Lawrence Seaway is certainly one of the top matters on the agenda. There is also another matter on the agenda which is going to be debated in the steering committee that may be higher on the agenda, and that is to fulfil the mandate on the tour of the north.

I thought at one time, before changes of chairmanships and new chairmen, that a subcommittee might do that. Since the new committee is smaller, there is a thought, and again committee members can discuss it, that the full committee should go north because it might be considered an insult if it did not.

There are many other things. We have the task force report on transportation, which is a Pandora's Box of many interesting problems. Something that really intrigues me in the committee—I throw it out for consideration to those diligent enough to get here today—to start thinking about perhaps for the fall, depending on what else happens between now and the summer adjournment, and I think there will be some disposition for this, is a committee or subcommittee of this standing committee to do something very much in the public domain, and that is this whole question of airports and airport security. But I just throw that out.

I think in view of the time, Mr. Reid, the steering committee is going to probably debate this and report back to the full committee. At least you have constituted the committee, so a steering committee can meet. We will meet, hopefully, as chairman, to pick a date, not necessarily during the next 10 days, if we adjourn. If there are other things that intervene after the 10 days, I certainly can still see a steering committee meeting, as long as the House is still functioning.

Mr. Angus.

Mr. Angus: Mr. Chairman, I would like to agree with the suggestion that we leave it to the steering committee. I think we, as a committee in our old self, clearly indicated we want to have that review and I do not think there is any problem with that.

Is it your disposition to try and get a steering committee together sooner? You are not thinking of tomorrow, are you?

The Chairman: Certainly the morning is out of the way. I would be open, quite frankly. I can see a couple of members of the steering committee there. We could meet tomorrow afternoon, if that is the disposition.

I must say, depending on the uncertainty here, I would like to have a steering committee meeting as early as possible, and if we could get it into tomorrow, by consent, because it is all by consent—

Mr. Angus: Why do we not try that? Because then there may be some things—

The Chairman: We can try it.

Mr. Angus: —that the clerk can follow through on during the break.

The Chairman: Exactly. That is exactly right. I have been informed by the clerk of the preliminary observations of one of the gentlemen sitting here, that getting in even a northern tour takes about a month's lead time and planning your calendars, as I was trying to do today, coming from the riding and having to listen to Mr. Robichaud several times on Bill C-75 over CBC, *anglais, francais*. It was very good, actually. You were darned fair. I was most interested. I almost drove off the road.

But in view of planning timetables, when you get that lead time, I was getting blocked into complications with June things, May things, and boom, you take 10 days, 12 days at least for the north and that can foul us up.

So I will try to convene a steering committee meeting. Are you going to be in town?

• 1545

Mr. Angus: Yes.

The Chairman: If you are going to be here, then we can have someone from.... Mr. Tobin phoned me but I did not get back to him.

Mr. Henderson: Okay. It will be Mr. Tobin or Mr. Robichaud.

The Chairman: Okay. We will check that out.

Mr. Robichaud: When, tomorrow?

The Chairman: I would say at 3.30 p.m. We will be in touch.

Mr. Robichaud: I will not be around at 3.30 p.m..

The Chairman: We have several things that we must attend to.

Thank you for your co-operation.

This meeting is adjourned to the call of the Chair.

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