IN THE MATTER OF AN ARBITRATION

BETWEEN:

VIA RAIL
(the “Corporation”)

-and-

UNIFOR
(the “Union”)

RE: PENSION PLAN FOR NEW HIRES

ARBITRATOR: MICHEL G. PICHER

APPEARANCES FOR THE CORPORATION :

Marc Benoit	**- Counsel**
Ed Houlihan	**- Director, Employee Relations**
François Quinty	**- Director, Investment Management**
Gerry Kolaitis	**- Director, Strategic Planning**
Josée Lamarre	**- Senior Advisor, Total Compensation**
F. Hubert Tremblay	**- Principal, Mercer**

APPEARANCES FOR THE UNION:

Brian Stevens	**- National Rail Director**
Corey Vermey	**- National Representative**
Bob Fitzgerald	**- National Representative**
Heather Grant	**- Council 4000**
Ken Hiatt	**- President, Local 100**
Jacques Ouimet	**- Vice-President, Local 100**
Bob Orr	**- Assistant to the President**

Hearings in this matter were held in Montreal, Quebec on April 14, 16 and 17, 2014 and July 23 and 24, 2014.

AWARD

This arbitration concerns a form of interest arbitration dealing with the pension plan which shall govern new employees hired on or after January 1, 2014. The Arbitrator's mandate is reflected in "Pension Attachment No. 2" dated June 13, 2013, which reads, in part, as follows:

> **Pension Plan**
>
> The parties have six months from the date of signing this agreement to reach an agreement on a new plan for employees hired on or after January 1, 2014.
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> In the event the parties are unable to reach an agreement, the matter will be decided by interest mediation/arbitration, the mediator-arbitrator to be agreed by the parties. The arbitrator shall consider, among other things, the impact on the current plan, the necessity, affordability and the sustainability of the plan proposed.

The parties executed a new collective agreement which was ratified effective July 1, 2013. They also executed "Pension Attachment No. 2" at the same time, allowing themselves the possibility to negotiate by agreement a new pension plan for employees hired on or after January 1, 2014. Failing agreement the matter would be determined by interest arbitration, which has led to this Award.

CORPORATION POSITION

The Corporation stresses that the status quo with respect to its Pension Plan for unionized employees, referred to by the parties as the "Unionized Plan", is not a viable option for the Corporation going forward. Employees hired prior to January 1, 2014 are part of a defined benefit (DB) plan. Because of what the Corporation views as a significant increase, over the last decade, of the level of risk inherent in a defined benefit pension plan, it proposes to place new employees, hired as of January 1, 2014, into a newly established hybrid pension plan. It takes the view that the status quo is not a viable option, given the high and volatile costs experienced in the last decade. It stresses the need to establish a new unionized plan which will have the appropriate affordability and sustainability, in a manner consistent with the mandate of Crown Corporations to maintain sustainable pension plans, as reflected in three consecutive Federal Government budgets from 2012 to 2014.

The Corporation notes that the existing unionized pension plan stands well above the plans of competitors in respect of its generosity, its costs and the risk exposure which it places upon the employer. In support of that assertion it notes that the Unionized Plan has generous ancillary benefits, such as indexation, early retirement subsidies and spouse protection. The Corporation's representatives note to the Arbitrator that many members would have, under the existing plan, a higher disposable take-home pay as retirees than they would as active employees, citing a net replacement ratio before taxes of 107 percent. Noting that the gross replacement ratio normally targeted is in the 50 to 70 percent range, the Corporation says that its proposed hybrid plan, comprised of both direct benefit and direct contribution elements would nevertheless yield a gross replacement ratio of 80 percent and a net replacement ratio of 93 percent, being well above the normal target replacement ratios.

The Corporation also stresses the cost of its current contribution to the Unionized Plan as a percentage of payroll. Noting that the normal percentage of payroll for employer contributions is generally in the order of 25 to 30 percent, the current plan involves an employee contribution of 5 percent of payroll and an employer contribution of 47 percent of payroll, a level which is described as problematic for the Corporation and not comparable to the levels carried by other organizations. The Corporation also points out to the Arbitrator the high volatility of the current defined benefit plan, given that the ratio of VIA's pension liabilities divided by corporate revenues is 300 percent over the period from 2007 to 2012. By comparison, 90 percent of the organizations listed on the TSX Composite Index which sponsor a DB plan carry a ratio of less than 60 percent, on average, with a median ratio being just over 10 percent. In other words, from the standpoint of volatility the Corporation's exposure is roughly five times more than found in 90 percent of comparable employers.

The Corporation also highlights the fact that the trend in pension plan coverage in recent years has been clearly away from defined benefit plans. Its representatives stress that in 2011 only 25 percent of private sector workers were covered by a registered pension plan in Canada. While in 2001 75 percent of those covered by a registered pension plan in the private sector were covered by a DB plan, the proportion was reduced to 50 percent in 2011. The Corporation's information is that currently no more than 12 percent of workers covered by a registered pension plan have the benefit of a DB plan.

What the Corporation proposes for UNIFOR-represented employees hired on or after January 1, 2014 is a hybrid plan. That plan would consist of a defined benefit (DB) component and a defined contribution (DC) component. Under its proposal the DB component would be entirely funded by employer contributions, while employee mandatory contributions would be directed to the DC component. In the Corporation's submission now is a good time to introduce a hybrid plan, given the relatively high expected number of retirements in the near future and the rate of replacement by the hire of new employees. It is anticipated that roughly 1,900 employees will leave employment with the Corporation in the next 12 years, while 1,750 new hires will enter service over the same period. With respect to what will happen in the future, the Corporation has tabled data before the Arbitrator suggesting that more than 55 percent of current active UNIFOR members are already eligible for retirement or will be eligible within the next 10 years. The Corporation notes that as at December 31, 2012 the average age of active UNIFOR bargaining unit employees was 44.4 years, their average service 15.3 years and their average earnings $54,300.00.

With respect to replacement ratios, the Corporation stresses that a UNIFOR-represented employee who retires from the Unionized Plan with an unreduced pension after 35 years of service benefits from a gross replacement ratio of 92 percent, a figure substantially above the 50 to 70 percent ratio normally considered sufficient by retirement experts. It stresses that the employee in question in fact would have more net income before taxes in retirement than while working, with net income after retirement being 107 percent of the employee's income before retirement.

The Corporation stresses that the trend is clearly away from DB plans, both in Canada and globally, particularly in the private sector. By way of explanation, it notes a number of factors, including the maturity of pension plans, stringent funding rules, low interest rates, volatile equity markets and greater life longevity, all of which have contributed to greater costs and risks of DB pension plans for employers. It submits that consequently more employers have converted DB plans to DC plans or discontinued their registered pension plans altogether. Its representatives note that in the private sector only 24 percent of workers were covered under either a DB or DC registered pension plan in 2011, a situation which contrasts dramatically from the public sector with an 86 percent rate of coverage. In that context, the Corporation submits that the hybrid plan is the most compelling and reasonable alternative, having regard to the elements of affordability and sustainability. It submits that generous DB plans are no longer prevalent among the Corporation's competitors or the appropriate comparative group of other employers. Its representatives stress the contributions to the DC component of the hybrid plan are fixed and predictable and afford the Corporation a better capacity to manage pension risks and liabilities. Over time, as new employees join the proposed hybrid plan the Corporation would, it submits, find itself in a better position to manage the risks and volatility of the DB portion of its plans. In the Corporation's view sustainability and the management of future risk are substantially better served by the hybrid model. Under that model it stresses that new hires receive a part of their benefit from the existing DB pension plan, pursuant to a reduced formula, and part of their benefit from a DC pension plan which is contributed to by both employees and the employer, with an overall 50/50 percent cost sharing.

What does the hybrid plan mean for the individual employee? In an attempt to answer that question the Corporation poses the example of an employee hired at age 30, who retires at age 65, with a final average salary of $60,000.00. In that situation, it submits that an estimated pension annuity, as calculated in 2013, would result in $13,800.00 per year in pension from the defined benefit portion and an additional $14,400.00 per year in pension based on a pension annuity purchase with the defined contribution portion, for a total pension of $28,200.00 per year.

In summary, the Corporation submits that the status quo is not an option, that its current pension liabilities are not sustainable and that the balanced approach of the hybrid model is the surest way to move forward with an affordable and sustainable plan. It maintains that the hybrid model shelters the Corporation from the risk of future unsustainability while providing its employees a generous gross replacement ratio that will assure a comfortable and dignified retirement to employees under the plan.

UNION POSITION

The Union notes to the Arbitrator that it represents employees under three separate collective agreements: Collective Agreement No. 1, which relates to off-train employees; Collective Agreement No. 2, which covers onboard services and, finally, Collective Agreement No. 3, which covers shopcraft personnel. It is estimated that some 2,100 VIA Rail employees are covered under the three collective agreements, in total.

In its submission to the Arbitrator the Union stresses that the interest arbitration process is accepted as being relatively conservative and that arbitrators have generally recognized that as a rule “breakthrough” provisions should not be realized through interest arbitration. The fundamental position of the Union in these proceedings is that the introduction of a hybrid DB-DC pension plan for unionized VIA Rail employees hired after January 1, 2014 does constitute a breakthrough provision that would not likely have been achieved through free collective bargaining.

In its submission to the Arbitrator the Union provides substantial information in relation to the overall context of pension plans in the rail industry, the Federal public service and other comparable employers within the top 100 pension funds, including Canada Post Corporation, Air Canada and NAV Canada. Reference is also made to the 2014 Federal budget which dealt, among other things, with “Alignment of Crown Corporations’ Pension Plans with the Public Service Pension Plan”. The Union’s representatives point out that in that document it is noted that the Federal Government was then working with Crown Corporations to implement a 50:50 employer-employee pension plan cost sharing, with the goal of requiring Crown Corporations to move to a 50:50 cost-sharing ratio as between employers and employees by 2017, in addition to requiring a raising of the retirement age for new hires to 65 years. The Government initiative also contemplated raising the age of entitlement to other benefits for new hires to correspond with the benefits available under the Public Service Pension Plan.

The Union looks to a number of other Federal undertakings as comparators, stressing that the Corporation's proposal for a hybrid DB-DC pension plan is not reflected in the plans of those Federal employers, many of which do negotiate with UNIFOR and, in the Union's view, faced similar pension issues in recent negotiations. In that regard reference is made to Marine Atlantic, NAV Canada and the St. Lawrence Seaway Management Corporation. Additional reference is made to Air Canada as a relevant comparator. The Union stresses that the current VIA Rail pension plan is largely consistent with the plans of those comparators. The plans of those employers are said to be comparable from the standpoint of benefit rate comparisons, member contributions and ancillary benefits, albeit there are some distinctions among them. Additionally, the Union notes that two of the comparative Crown Corporations record reliance on letters of credit to finance their solvency deficiencies. The Union maintains that that alternative is also available to VIA Rail.

The Union's presentation also examines the Air Canada DB-DC hybrid pension plan established in the award of Arbitrator Kevin Burkett dated September 17, 2011, a decision dealing with employees also represented by this Union. The Union's representatives note that in that award Arbitrator Burkett selected the Union's proposal to maintain a defined benefit pension plan for new hires in the form of a hybrid with a DC plan component. The Union also notes that under the Corporation's proposal new hires would be left outside the benefit structure of the current plan and would be without access to ancillary benefits, subsidized normal forms of payment and the indexation of the current plan.

Particular reference is made as well to a prior award of this Arbitrator in relation to pension issues resolved as between NAV Canada and the Canadian Air Traffic Control Association (CAW-Canada, Local 5454 – now UNIFOR, Local 5454). The Union's presentation to the Arbitrator notes that the treatment of new hires under the plan there under consideration constituted a defined benefit plan for new employees.

In approaching the hybrid plan the Union stresses that in a DC plan, while employers make contributions which remain constant and do not vary with the performance of the plan, the ultimate retirement income provided to DC plan retirees remains uncertain and unpredictable. Such plans clearly afford an advantage to the employer to the extent that DC plan contributions are not volatile. The Union also notes that enrolling new employees in the existing DB plan would tend to reduce the volatility in the contributions of the DB plan, effectively maintaining ongoing contribution levels to the existing plan's fund. The Union's representatives stress that maintaining the participation of new hires in a DB plan mitigates the factors of uncertainty, reducing the risk of employer contribution volatility. The Union questions the value of closing the existing plan to new hires to the extent that to do so would have a negative effect on the funding of the existing DB plan. Additionally, the Union questions the advisability of the DC plan design which would leave investment and allocation decisions to individual account holders, as compared with the monitoring of asset allocations by professional plan administrators who oversee DB plans. Additionally, the Union argues that management by individual account holders, as would occur under a DC plan, tends to leave risk averse employees with conservative portfolios, often with low yielding and high fee GICs. The risk, the Union argues, is that plan members will ultimately realize less favourable retirement incomes.

Further to that theme, when replacement ratios are examined, the Union notes what would be the substantially different treatment of employees who attain age 65 with 35 years of service. As noted above, the net replacement ratio currently for those persons would be a benefit of 107 percent. Conversely, under the hybrid plan the same employee would realize a net replacement ratio of 57 percent.

The Union also alerts the Arbitrator to what it describes as the greater likelihood of inequality as between the treatment of employees under a DC plan. It submits that otherwise similarly situated employees can have substantially different retirement incomes, depending on such factors as the timing of their election to retire, as it might relate to interest rates or annuity rate risks. Citing the example of 2009 as compared with 2007, it submits that retirement following a major market correction or during a period of low interest rates can result in a substantially lower retirement income for the employee than might have been received by another employee whose retirement timing was more fortuitous.

Central to the Union's position is that DB plans place the risk of the plan essentially on its sponsor, generally the employer, to the extent that the employer becomes responsible for any shortfall in the plan, as for example if pensioners achieve a greater than expected longevity of life. The Union cites the words of former Bank of Canada

Governor David Dodge on the occasion of a speech in Montreal on November 9, 2005 where the following comment, in part, was made:

> By pooling these risks, pension funds generate important benefits in terms of economic efficiency. By transferring risk from individuals to collectives, pension funds help achieve a more efficient allocation of savings. Pension funds – particularly the very large ones – tend to have sophisticated asset managers. These large funds have the incentive and the ability to invest pools of contributions across appropriately varied asset classes. Further, they invest over very long time horizons, so they can finance large investment projects at competitive rates of return. All of this contributes significantly to economic efficiency by transferring risk to those investors that are best able to bear it.

In the Union's submission, it is not insignificant that historically, largely by reason of the professional management of assets, DB plans tend to achieve superior investment performances compared to what might be realized by the average individual investor. Citing a publication by Almeida and Fornia entitled "A Better Bang for the Buck", it notes the comment that: "Prior research substantiates DB plans' significant advantage in investment returns, as compared with DC plans." The Union's fundamental position is that opting for DC plans, in whole or in part, essentially shifts the risk to the employee who, in the end, may well be in the least sophisticated position to understand and manage risks and volatility.

The Union also questions the impact of the hybrid plan on the viability of the current plan. It stresses that in accordance with the estimates in the Mercer report as well as in the Poulin report, within some 10 years the proposed hybrid plan may well equal if not surpass the membership of the current plan, thereby threatening its continuing viability "from a political perspective".

I turn to consider the submissions of the parties. In doing so I find it difficult to avoid acknowledging, at the outset, what is arguably the dysfunctionality of the current pension system. Given current pension norms in Canada, which generally target growth replacement ratios to fall within the range of 50 to 70 percent, the 92 percent gross replacement ratio of the status quo plan, and the 107 percent net replacement ratio of that plan, are arguably dysfunctional. I find it difficult to reconcile the fact that, under the status quo, with a net replacement ratio of 107 percent, a retired employee will in fact earn more than he or she would do in active employment. Based on the submissions of the Corporation, there is also little or no reason to be concerned that the hybrid plan which the Corporation proposes would result in an unduly harsh effect. It is estimated that the gross replacement ratio for the proposed hybrid plan would be at 80 percent, while the net replacement ratio would be 93 percent, well above generally targeted replacement ratio rates.

I also consider it significant that the proposed hybrid plan would not realize anything close to a windfall for the Corporation in respect of current service costs. The Corporation's projection for current service costs as between the status quo and the hybrid plan, for the period between 2015 and 2033, indicates that the status quo would see the CSC rise to 6.1 percent, whereas the proposed hybrid would rise to 5.1 percent over the same time. On that projection, the hybrid plan would give the Corporation a comparable one percent reduction in current service costs over that long term period. However, as the Corporation acknowledges in its presentation, arguably the real benefit of the hybrid plan is that it deals with risk rather than dealing with cost.

In the result, and having substantial regard to what I consider to be the dysfunctional nature of the current plan, I find myself compelled to agree with the position of the Corporation, subject to certain qualifications. I accept that a hybrid plan based on the proposal of the Corporation is the preferable alternative from the standpoint of long term affordability and sustainability. I accept the Corporation's submission that a continuation of the status quo would leave the Corporation in a position of potentially unacceptable liability and risk, and that the alternative which it proposes, albeit not as generous as a pure DB plan, leaves its employees hired after January 1, 2014 with a reasonable pension consistent with a dignified retirement.

I consider, however, that there is one important qualification to be applied to the proposal put forward by the Corporation. Its hybrid plan, while establishing partial DB protection for employees, does not include any mechanism for adjustment of the DB portion of the plan in the face of inflation. It is less than clear to me that retirees under the plan here under consideration should necessarily be relegated for life to a "fixed income" with little or no protection against the possibility of future inflation. I therefore consider that it is appropriate, at least insofar as the DB portion of the Corporation's proposal is concerned, to build in a form of indexation for the DB portion. To that end I consider the proposal on benefit indexation put forward by the Union in its position filed before me on April 14, 2014 to be an appropriate formula. While I am satisfied that I should direct the implementation of the hybrid plan proposed by the Corporation, that plan should be further qualified by engrafting on it, insofar as the DB portion of the plan is concerned, the benefit indexation proposal tabled by the Union on April 14, 2014.

I therefore adopt the Union's proposal on benefit indexation as part of this Award, to apply to the DB portion of the Corporation's hybrid plan. For clarity, the Union's proposal, which I accept for the purposes of indexation of the DB portion of the pension plan, reads as follows:

> **Benefit Indexation**
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> Amend the plan text such that employees hired by VIA RAIL on or after January 1, 2014 or such later date by agreement of the parties, shall upon retirement receive a post-retirement pension increase of the Defined Benefit portion of the hybrid plan on each April 1 following the third anniversary of the pensioner's retirement or death (in respect of survivor pensions payable), whichever occurs first.
>
> The increase will be conditional on the CPI increasing more than 3.0% from the retirement date and on the pension fund being in surplus on a going concern basis and shall be further subject to a maximum adjustment of three (3.0%) percent per annum.
>
> It is understood that the post-retirement pension factor shall be identical to that of pre-2014 plan members and equal to fifty percent (50%) of the percentage increase in the CPI during the preceding calendar year and subject to the total maximum annual pension payable under Section 7.8.
>
> Any existing indexation provisions relating to new-hires as of January 1, 2014 are to be maintained.

Subject to the foregoing qualification, the Arbitrator adopts the hybrid plan proposal put forward by the Corporation as the pension plan directed by this Award and it is so ordered.

I retain jurisdiction in the event of any dispute between the parties concerning the interpretation or implementation of this Award.

Dated at Ottawa, Ontario this 7th day of October, 2014.

Michel G. Picher
Arbitrator