CANADIAN PACIFIC

SUBMISSION TO THE DEPARTMENT OF FINANCE CANADA IN RESPONSE TO ITS JANUARY 2009 PENSION PLAN CONSULTATION PAPER

March 12, 2009

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INTRODUCTION

Canadian Pacific welcomes the opportunity to make this submission to the Department of Finance Canada in response to the Department's January 2009 consultation paper entitled *"Strengthening the Legislative and Regulatory Framework for Private Pension Plans Subject to the Pension Benefits Standards Act, 1985"*.

Canadian Pacific supports the Department's initiative to enhance the legislative and regulatory framework for pension plans registered under the Pension Benefits Standards Act, 1985. In addition, we recognize the need to balance the interests of plan sponsors and plan members in ensuring the viability of defined benefit pension plans while ensuring the security of members' benefits.

Canadian Pacific strongly believes that meaningful, permanent action by the Federal Government is urgently required to address the onerous nature of the current solvency deficit funding rules for defined benefit pension plans. The current rules severely limit Canadian Pacific's ability to continue to invest the capital required to meet our infrastructure needs and to grow our business. The negative consequence of these rules will have adverse impacts not only for Canadian Pacific and its employees and retirees, but also for our customers and the Canadian economy, given the role played by railways to facilitate the country's trade and economic growth. In addition, without meaningful, permanent changes to the funding rules, Canadian Pacific's ability to maintain our defined benefit pension plan will be severely challenged.

We are sharing our views on the urgent need for change with our employees, the various unions that represent our employees and our pensioners' association, and are providing them with access to this submission.

We consent to this submission being posted on the Department of Finance web site and to a copy of this submission being forwarded to OSFI.

BACKGROUND

A. About Canadian Pacific

Canadian Pacific is a transcontinental railway in Canada and the United States and provides logistics and supply chain expertise. CP provides rail and intermodal transportation services over a network of approximately 15,500 miles, serving the principal business centres of Canada from Montreal to Vancouver and the U.S. Northeast and Midwest regions. CP's railway feeds directly into the U.S. heartland from the east and west coasts. Agreements with other carriers extend CP's market reach east of Montreal in Canada, throughout the U.S. and into Mexico.

CPR's business is very capital-intensive. Over the last five years, we have spent, on average, $825 million per year to sustain our network and provide for our base business needs – these investments equate to 17% to 20% of our annual revenues.

B. About CP's Defined Benefit Pension Plan for Canadian Employees

Canadian Pacific has a single defined benefit (DB) pension plan that covers over 90% of our 14,000 Canadian employees and provides pensions to 22,000 retired employees and their survivors. All of our Canadian unionized employees participate in this plan, while non-union employees have a choice to participate in either the defined benefit plan or a defined contribution plan (with about two-thirds of the non-union employees in the DB plan).

Our DB pension plan is one of the largest corporate pension plans in Canada, with assets of $6 billion (as of December 31, 2008).

Canadian Pacific's pension contributions over the last six years have been large and volatile. Over this period, CP has contributed approximately $1 billion to this DB pension plan, including almost $600 million of solvency deficit contributions over the first four years of this six year period.

The severe decline in global equity markets in 2008 has led to a significant deterioration in our DB plan's solvency funded position, from a small surplus as at January 1, 2008 to an estimated deficit, with assets reflected at market value, of $1.6 billion as at January 1, 2009. Despite this severe decline in global equity returns, the plan remains reasonably well-funded, with the market value of the plan's assets as at January 1, 2009 equal to 80% of the plan's estimated solvency liabilities.

Canadian Pacific's pension plan has, over the 106 years that it has been in existence, made a significant contribution to the security of our employees and pensioners. We remain committed to meeting our pension obligations in a responsible manner. We have never missed a payment to any of our pensioners, a record that we are proud of and a legacy we want to continue to build on.

URGENT CHANGE REQUIRED TO SOLVENCY FUNDING RULES

It is critical that meaningful, permanent changes to the regulatory framework be made in 2009 to address the onerous and volatile nature of solvency deficit contributions required under the current rules.

Canadian Pacific is requesting that the solvency deficit funding period be permanently increased from five to ten years for all current and future solvency deficiencies, without any conditions.

The temporary solvency funding measure announced in the Government's November 2008 Economic and Fiscal Update, although welcomed by Canadian Pacific, is insufficient for a number of reasons. For companies such as Canadian Pacific who have adopted a conservative approach to solvency funding by utilizing an asset smoothing method, it is understood that the temporary solvency funding measure will not provide a longer amortization period in respect of the significant portion of the 2008 investment losses for which the asset smoothing method defers recognition to future years' actuarial valuations. In addition, this temporary measure does not address the continuing onerous nature of the five-year solvency funding rules, nor does it address the continuing decline in global equity markets in 2009. There are structural issues with the current funding rules, which require immediate, permanent changes.

It is imperative that ten year solvency deficit funding be provided without any conditions:

- Requiring consent from plan members and/or their collective bargaining agents for longer amortization periods is burdensome and inappropriately shifts this public policy into the collective bargaining realm. We are of the view that the Government needs to, in a balanced way, make meaningful changes that do not create an ongoing requirement for plan-specific, plan member buy-in. As previously mentioned we are working diligently, in good faith, to give our plan members ample opportunity to present their views as an input into your consultation process. We feel plan members views should be an input into this consultation process, not an onerous plan-specific requirement going forward.

- Letters of credit are no longer an inexpensive, readily accessible means of securing pension benefits. A requirement to post letters of credit in return for longer solvency deficit funding periods could result in a sponsor's available credit capacity being fully utilized for pension purposes. In the current economic environment, securing additional credit capacity will be much more costly and may negatively impact the company's access to capital; while for some companies additional credit capacity will not be available.

We acknowledge the critical importance of the security of pension plan members' benefit payments. We strongly believe that the best security for plan members is a financially strong plan sponsor, and that our proposed lengthening of the solvency deficit funding period is critical to ensuring that Canadian Pacific remains financially strong.

Canadian Pacific urges the Government to permanently lengthen the solvency deficit funding period this year. We require more certainty now around our future years' pension contributions as we proceed with the development and implementation of our corporate capital and operating plans. In addition, unless meaningful, permanent changes are made to solvency funding rules, the ability of Canadian Pacific to maintain our current DB pension plan will be severely challenged.

RECOGNIZING THE NEED FOR A BALANCED APPROACH TO STRENGTHEN THE LEGISLATIVE AND REGULATORY FRAMEWORK

Canadian Pacific recognizes the need for a balanced approach for strengthening the legislative and regulatory framework. In return for ten year solvency funding with no conditions, we support the following changes in the regulatory framework:

1. A requirement for plan sponsors to fully fund any deficit on plan termination (with such funding either, at plan sponsor discretion, made in a lump sum or amortized over a period of up to five years). It is imperative that the outstanding obligation be treated as unsecured debt of the sponsor and not rank ahead of any of the sponsor's other unsecured debt.

2. A requirement that plans must file actuarial valuation reports annually with OSFI, irrespective of the plan's funded status.

3. Greater disclosure to all plan members of the plan's funded status, the plan's investment policy and a statement of funding policy. The statement of funding policy should address the sponsor's policy with respect to contribution holidays, but should refrain from addressing those funding issues which are linked to the sponsor's management of the financial risks associated with the operation of its business and are typically reserved for decision by the sponsor's board of directors and therefore considered confidential.

4. A prohibition on plan improvements if a plan is less than 85% funded on a solvency basis (or if the improvement would result in the funded status dropping below this 85% threshold).

5. An increase in the current Canada Revenue Agency "excess surplus" limit on employer contributions above its current 10% surplus threshold to 25%, thereby giving employers the option to pre-fund cyclical market downturns.

Provided that the solvency deficit funding period is extended from five to ten years with no conditions, Canadian Pacific would also support reasonable restrictions on the use of surplus for contribution holidays, such as a requirement that surplus be amortized over the same ten year period as solvency deficits in determining the amount of surplus that can be applied in any year against employer current service costs. Canadian Pacific views such a restriction as being much more equitable for mature pension plans (such as our plan) than a provision for adverse deviations that other stakeholders may be proposing.

ADDRESSING RISK/REWARD ASYMMETRY

Although pension plan surpluses may appear remote at the present time, the conservative nature of the solvency liability calculation, together with the required amortization of solvency deficits, ensures that trapped capital and risk/reward asymmetry issues will emerge at a future date. We encourage the Government to address these issues at the present time.

A practical approach to addressing trapped capital and risk/reward asymmetry is to permit plan sponsors to use letters of credit in lieu of solvency contributions, to the extent that these contributions exceed going-concern deficit contributions. The letters of credit must be permitted to be reduced or canceled if a solvency surplus later develops. Both Alberta and British Columbia have adopted this approach on a permanent basis.

For letters of credit to be effectively utilized for this purpose, they must be an alternative source of funding that sponsors can voluntarily utilize. They cannot be a trade-off for lengthening solvency deficit amortization periods for the reasons outlined earlier in this submission.

We request that the Government permit sponsors to utilize letters of credit for this purpose.

SUMMARY

The rules for dealing with solvency deficits have not kept up to changes in globalized markets, nor are they flexible enough to deal effectively with the extreme volatility in financial markets. The net result is that current rules are too burdensome for plan sponsors and are leading to the undermining of the competitive position of Canadian companies. We cannot continue to deal with successive crises on a year to year basis. Canadian Pacific needs greater certainty than can provided by temporary relief measures – this certainty can only provided by a meaningful, permanent solution.

To provide the needed funding flexibility for sponsors, we urge the Government to lengthen the solvency deficit funding period for all current and future solvency deficiencies from five to ten years without any conditions. With the continuing lack of liquidity in the capital markets and the continuing decline in equity markets in early 2009, and with the need for companies to plan now for their increased pension contributions over the next several years, it is critical that this issue be urgently addressed.

Without meaningful, permanent changes in the solvency deficit funding rules, Canadian Pacific will not be able to invest the necessary capital to fully meet our infrastructure needs and to grow our business, while our ability to maintain our defined benefit pension plan will be severely challenged. Lengthening the solvency deficit funding period from five to ten years would free up hundreds of millions of dollars for Canadian Pacific to productively invest within our business for the benefit of all of Canadian Pacific's stakeholders, the communities in which we operate and the Canadian economy.

Canadian Pacific believes that our proposals are consistent with the Government's objective of enhancing benefit security while providing a more stable pension funding framework.

Canadian Pacific has welcomed the opportunity to make this submission to the Department of Finance, and we look forward to continuing our dialogue with Finance.