

February 4, 2004

Mr. Anthony J. Devir
Osler, Hoskin & Harcourt LLP
Box 50, 1 First Canadian Place
Toronto, Ontario
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Dear Mr. Devir:

Subject: Air Canada Pension Plans

Further to our conference call on January 23rd and our meeting of January 27th, the purpose of this letter is to confirm the issues that were discussed. As we indicated at the outset of the meetings, OSFI's position on a number of these matters has been provided to Air Canada and the beneficiary groups throughout the process. The purpose of our meetings with you was to clarify, at your request, OSFI's position on a number of these issues and in particular highlight those that remain outstanding

As we stated, it is OSFI's position that the directions issued in 2003 in respect of the pension plans create an obligation on Air Canada and, pursuant to the *Pension Benefits Standards Act, 1985* ("PBSA, 1985"), amounts owed in accordance with this obligation are subject to a deemed trust. On December 12, 2003, OSFI provided to the Monitor a spreadsheet outlining a possible funding scenario that included a suggested schedule for satisfying the amounts owed as a result of the directions (subsequently provided to you following our initial January 23rd discussion). OSFI was informed that the Monitor provided Air Canada with a copy of this spreadsheet. It is OSFI's view that this schedule reflects a reasonable payment schedule, balancing Air Canada's financial capability with the protection of the interests of the plans' beneficiaries and the need to meet OSFI's satisfaction with these matters. It would be difficult for OSFI to support a further repayment schedule for these amounts, which OSFI views as currently due and owing to the pension plans. As mentioned at our meeting of January 27th, a copy of this spreadsheet has been provided to the beneficiary groups.

A number of issues related to the funding of the plans were also raised. These included the application of actuarial gains and losses and the treatment of future benefit improvements. As

indicated during the meeting, we understand that the application of actuarial gains and losses has been a topic of discussions between the beneficiary groups and Air Canada, to which OSFI has not been a party. OSFI is of the view that:

- deficiencies arising from future benefit improvements should not be funded over ten years;
- smoothing of assets in the valuation of the solvency deficiencies will not be permitted;
- and Air Canada will be required to file annual valuation reports for all plans.

Notwithstanding these views, as we indicated, OSFI's position on many of these issues is dependent upon its consideration of all the terms that are finally agreed upon between the beneficiary groups and Air Canada. We do, as always, remain open to pursuing discussions with Air Canada and all appropriate parties to resolve these matters.

As we discussed, prior to any regulatory changes being presented to the government, the parties must evidence a level of support, or "buy in", on the part of plan beneficiaries to the proposed extension for funding of the plans' deficiencies. This issue has been raised numerous times by OSFI and we have also advised on numerous occasions that it is incumbent upon Air Canada and the beneficiary groups to submit a proposal to the government for this buy-in process. We had previously discussed with representatives of Air Canada and the Monitor a number of elements that we believe could form part of an acceptable and workable proposal in this regard.

We also discussed, in general terms, a number of amendments to certain plans that are currently outstanding (for example, the George Adams Award). We will be working with the plan administrator over the coming weeks to review the necessary information and move forward on these amendments as appropriate.

Finally, any decision with respect to changes to the regulations required to accommodate a proposed ten- year funding of the plans' deficiencies lies with Cabinet, on the recommendation of the Minister of Finance. The Department of Finance, in making a recommendation to the Minister, will look to OSFI for its view on any proposed changes. Although OSFI has commenced development of a regulation, it is obviously not possible to finalise it without bringing the issues noted above to conclusion. Considerable time has elapsed since the commencement of discussions with Air Canada on the pension matters. Time continues to be of the essence. Whether any changes can be implemented within a timeframe envisaged by Air Canada, the Monitor or Trinity will depend on the completeness of the submitted package, the extent to which the package addresses the Principles that have been discussed with both Air Canada and the beneficiary groups over the last number of months and the date at which the submissions are received by OSFI and the Department of Finance.

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Should you require further clarification in connection with the matters outlined above, please do not hesitate to contact me.

Yours truly,

Carol Taraschuk
Counsel
Legal Services

cc: Michel Benoît, Osler, Hoskin & Harcourt
Serge Charbonneau, AON
John Baker, Air Canada
Monitor
Service List