Peter J Edwards
Vice President,
Human Resources and
Industrial Relations

Suite 500
Gulf Canada Square
401 – 9th Avenue S.W
Calgary Alberta
T2P 4Z4

Tel: 403-319-3235

peter_edwards@cpr.ca

March 27, 2013

This letter is intended to give you an understanding of the background issues and the impacts of a cap on union and management pensions drawn from the plan we jointly share.

Why the Change?

Defined Benefit ("DB") Pensions have been an issue at every company that has one; Air Canada, Abitibi, CN, Sears Canada and many more.

Towers Watson reported in the February 26th Wall Street Journal that only 11 of the Fortune 100 Companies have any sort of traditional pension plan. This is down from 89 in 1985. The change has been and continues to be dramatic.

There are lots of contributing issues-low interest rates, low stock market returns, plan design and the simple fact that people are living a lot longer. For CP the confluence of these factors meant we had to cover 3 billion dollars in solvency losses in the past 5 years.

Early on it became clear that it was a serious problem that required action. At CP we began dealing with the issue a number of years ago.

In 2010 we closed the DB pension plan for new management employees. In its place for new and existing employees who selected this option, we enhanced our market competitive, portable pension – the Defined Contribution ("DC") plan. This design change meant that we pay in a real time basis and don't have to pre-fund liabilities that will be paid in the far future. As it is with a DB plan the company must start funding, as soon as you join the company, all your pension including anticipated pay raises until your estimated retirement date. This puts a big liability upfront and long before it is paid out. With a DC plan the company contributes into your pension accounts on the salary you have and as you earn it.

This is a big issue with DB plans and one we can't fix as a company. It is the structure of the Federal regulations regarding pension plans.

We understand why the Government has the regulations the way it does; it just makes these plans very difficult to have.

This change to a DC plan for new employees prevented a further, very material, increase in our solvency liability.

With this, and other changes to the management plan in place, it was time to look at the plans with the vast majority of our employees who are represented by unions. This was particularly important as we are the only Class I railway to have uncapped union pension plans.

The Negotiations:

Beginning with the running trades and rail traffic controllers, we offered the opportunity to open the management DC plan to all unionized new hires. This was not what the union leadership wanted and we respect that. Different groups of people have different needs.

We looked at other changes that would also reduce the impact and, after careful consideration, the union leaders concluded that a cap was the most acceptable of a table of least favourite alternatives.

In the end, we did not reach an agreement and there was a strike, a legislated return to work and a mandatory arbitrated settlement.

The arbitrated settlement imposed a higher cap of $2,200. One of the additional requirements of the arbitration was that we implement a cap on management pensions paid from this plan.

Why it is important.

Some might ask "why must management make additional changes when they have made significant ones in the past "?

First, it is a joint plan that is in deficit. For management to continue to remain uncapped in this plan would mean that their uncapped pensions would cause it to take longer for the plan to recover. Second, we envision that once markets and interest rates recover and the Company has recouped its extraordinary contributions that we would look to improve the base plan, when the plan's investment returns would allow us to do it on a sustainable basis. We expect we would do this in conjunction with the unions that have signed this undertaking in their agreements.

These points, taken together, mean it simply does not make sense for management to remain uncapped in the joint plan.

Thus what we have agreed to with four union groups and the arbitrator ruled with two others makes sense.

So we are implementing a cap as of January 1st 2013 for all <u>future service</u> in any pension paid from this plan. This in no way reduces pension earned to date or the rate it was earned at. The cap will be at $2,200 for running trades and rail traffic controller pensions drawn from this plan. This in no way reduces pension earned to date or the rate it was earned at.

This cap will only affect you in the future if your 5 year average pensionable earnings are over $115,000.

Even with these changes, the pension earned by our unionized employees continues to exceed that of our major competitor.

Will it satisfy everyone? No.

There are some elements in the Union plan that managers would like. There are elements in the management plan that the union would also prefer. The challenge is you cannot pick and choose items or timing. What we can do is put together total compensation plans that are competitive for the markets in which we operate, the employees we want to attract and retain and are sustainable for the Company in the near and long term.

Please recognize, the joint plan will recover and improvements will be made for all when it is sound and sustainable to do so. Other improvements in our compensation levels can also be expected as we meet the challenges of our five core beliefs and become the most efficient railway in North America.

Yours truly,

Peter Edwards
Vice President, HR/IR