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Pension Innovation for Canadians: The Target Benefit Plan

NATIONAL PENSIONS AND BENEFITS LAW SECTION
CANADIAN BAR ASSOCIATION

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PREFACE

The Canadian Bar Association is a national association representing 37,500 jurists, including lawyers, Quebec notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Pensions and Benefits Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Pensions and Benefits Law Section of the Canadian Bar Association.

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Pension Innovation for Canadians: The Target Benefit Plan

I. EXECUTIVE SUMMARY

The National Pensions and Benefits Law Section of the Canadian Bar Association (CBA Section) is pleased to comment on Finance Canada's consultation on Pension Innovation for Canadians: The Target Benefit Plan (TBP) published on April 24, 2014.

The CBA is a national association of 37,500 lawyers, Quebec notaries, students and law teachers, with a mandate to promote improvements in the law and the administration of justice. The CBA Section is comprised of lawyers from across Canada who practise in the pensions and benefits area of law, including counsel to benefit administrators, employers, unions, employees and employee groups, trust and insurance companies, pension and benefits consultants and investment managers and advisors.

The CBA Section believes that promoting retirement income security for Canadians is an important function of government and commends Finance Canada for leading the discussion on TBPs across Canada.

The CBA Section supports expanding the availability of the target-benefit model to the federally regulated private-sector and single-employer environments for the policy reasons outlined in the consultation.

While we support the TBP initiative, there are varying viewpoints on their appropriate structure. Our comments provide guidance and a pathway for the government to establish a legislative framework for TBPs. Our comments are organized according to the headings in the consultation.

4.1. Administration and Governance

The financial features of the TBP should be decided when the plan is established and incorporated into the constating documents. We support a less prescriptive approach that leaves plan design to be determined by the parties based on the circumstances of the plan. Legislation should be prescriptive on matters of pure plan administration and portability of

TBP benefits. In establishing or converting plans and composition of the governing body, there is no consensus on how prescriptive the legislation should be.

We believe that the main features of the plan (e.g., risk sharing formula, benefits, etc.) should be negotiated (subject to minimum standards in the legislation) and the Board's function should be to implement the terms of the deal in the established framework. It may be desirable to incorporate a sponsors committee into the governance structure to accommodate non-unionized plans and Multi-Employer Pension Plans (MEPPs), provided that safeguards, such as independent advisors, are in place to ensure plan members are properly represented on the committee. The sponsors committee should be comprised of employer representatives and representatives of the different member groups, including retirees, and function analogously to that of a union in a unionized context.

Board's power: we agree that the key to successful TBPs is to set out the rules in the initial plan documents and to maintain these rules over the long term. Changes to documents should be rare and only permitted where there are significant problems or broad acceptance by members and retirees.

Support for significant changes: the CBA Section believes that any consent or opposition process needs to be fair and all affected plan members should, at a minimum, have the opportunity to voice their opinions on substantive proposed amendments to the plan documents. If an amendment affects two or more groups of plan members, the prescribed consent or opposition process should apply independently to each group.

In the negotiating process, non-unionized employees (as well as unrepresented retirees and deferred vested members in a unionized environment) should be involved in negotiating the initial policies and plan text, and due to the shared risk nature of TBPs, should have some involvement in TBP governance.

The involvement of all interested parties at the beginning of the TBP initiative might slow progress. However, it may encourage support for a TBP proposal and could reduce the potential for future disputes.

4.2. Funding Policy

We agree with the general requirement for the plan administrator to establish a funding policy for the TBP which must be submitted to OSFI.

If the margin or the probability test is not prescribed by legislation, it should be determined by the parties as part of the negotiation of the plan terms. The Board could have the responsibility of creating the funding document within the parameters agreed to by the parties.

Some of our members believe that, regardless of the approach chosen for the framework, an approach with a well-defined methodology based on the Canadian Institute of Actuaries (CIA) Standards of Practice is preferable.

4.3. Contributions

The TBP is designed to operate with fixed contributions and should be established by the parties. Any variation in contributions should be pre-established and any amendments outside the permitted range should be on an exceptional basis only. Contribution increases should be allowed provided the range is limited and prescribed or determined by the parties. In addition, the parties should decide the priority order of contribution increases or benefit reductions.

4.4 Benefit Structure

We believe that the approach of categorizing benefits in two classes is the only method to prioritize the order of benefit reductions.

4.5. Funding Deficit Recovery Plan

We recommend that the required deficit recovery measures regulations not be overly prescriptive. However, base benefit reductions should be a last resort. The deficit recovery measures and their prioritization must be set out in the constating documents for the plan. We support the position that the Board be required to implement the deficit recovery plan as soon as the threshold funding measure is not satisfied.

4.6. Funding Surplus Utilization Plan

We recommend against overly prescriptive regulations on surplus utilization measures. The plan stakeholders should have considerable flexibility in determining the specifics of a surplus utilization plan when the plan is established. The funding surplus utilization plan should be set out at the beginning of the constating documents. We suggest that the surplus utilization plan work in tandem with the funding deficit recovery plan so that the surplus must first be applied to reverse any reductions previously implemented under a funding deficit recovery plan.

4.7. Disclosure and Communications

Clear communication to stakeholders is a critical component of the TBP model. To avoid plan member confusion, the plan administrator should balance the competing needs for comprehensiveness and comprehensibility in any communications.

We agree with the approach of building on and expanding the existing disclosure requirements in the *Pension Benefit Standards Act* (PBSA) for ongoing disclosure relating to the plan. We also agree with the proposed filing requirements.

Prior to disclosure to members, the plan sponsor(s) should be notified of any changes. This permits the plan sponsor(s) to implement any required changes to its systems and to brief its staff.

4.8. Conversion of Pension Plans to Target Benefit Plans

In a conversion from a Defined Benefit (DB) plan, we suggest that any requirement to obtain consent from active members and retirees with significant accrued benefits be polled separately from those without. If the legislative goal is to facilitate conversion of accrued benefits to a TB format other than by unilateral action of a DB plan sponsor, conversions should only be able to proceed with informed consent.

TBP legislation could provide an offer of consideration in exchange for obtaining consent to convert accrued benefits. We do not believe, however, that an exhaustive list of what would be consideration for consent in the legislation is required.

A legislative regime for conversions based on informed negotiation would reduce the necessity to prescribe a restrictive regime for funding and investment policies designed to reduce the risk of benefit reductions.

Any future rules should facilitate the ability of DC plans to convert to TBPs. The actuarial value of a member's TBP entitlements should not be less than the market value of the member's DC assets at the time of conversion.

4.9. Portability and Locking-In Rules

Locking-in is an important principle of pension regulation. We question whether the PBSA's 50% unlocking rules will apply to TBPs. For portability, the conditions to transfer out of a TBP and the options available on a transfer should follow the current PBSA model. Due to the nature of TBPs and the ability to reduce accrued benefits in a TBP, the calculation of the

transferring member's pension benefit credit will require specific regulations. TBP legislation must address the impact of excess amounts and deficits.

4.11. Plan Termination and Wind-Up

We support including an anti-avoidance provision in the legislation to prevent plan sponsors from converting plans solely to get around current funding obligations related to a DB plan.

4.12. Application to Multi-Employer Plans

We generally support the conversion of MEPPs to the TBP framework. However, it is necessary to establish separate TBP rules tailored for the unique characteristics of this type of plan. The funding rules tailored to plans providing target benefits rather than defined benefits may be appealing for existing MEPPs, namely the exemption from solvency funding. On the other hand, a highly-prescriptive governance structure may be less appealing.

The legislation should reflect the fact that MEPPs already have many features of a TBP by recognizing certain aspects of the governance structure of the MEPP as equivalent to the proposed requirements for single employer plans. The proposed anti-avoidance mechanism should not apply in the context of a MEPP.

II. INTRODUCTION

The Canadian Bar Association's National Pensions and Benefits Law Section (CBA Section) is pleased to comment on Finance Canada's consultation on the proposed Target Benefit Plan (TBP) framework released April 24, 2014.

The Canadian Bar Association is a national association of 37,500 lawyers, Quebec notaries, students and law teachers, with a mandate to promote improvements in the law and the administration of justice. The CBA Section is comprised of lawyers from across Canada who practise in the pensions and benefits area of law, including counsel to benefit administrators, employers, unions, employees and employee groups, trust and insurance companies, pension and benefits consultants and investment managers and advisors.

The CBA Section believes that promoting retirement income security for Canadians is an important function of government and commends Finance Canada for leading the discussion on TBPs across Canada.

TBPs have been in existence for decades and are common in collectively-bargained multi-employer and public sector environments. New Brunswick was the first jurisdiction to implement a new TBP framework available to single employer plans in a unionized or non-unionized environment. As other jurisdictions are expected to introduce TBP legislation in the near future, it is desirable that TBP legislation be harmonized across Canada. Finance Canada's initiative and consultation may serve as a model for other jurisdictions to follow.

The CBA Section has commented extensively on the federal Pooled Registered Pension Plan (PRPP) framework implemented in 2012. We believe the proposed TBP framework will complement PRPPs by providing an additional retirement income plan for employers who currently sponsor a workplace pension plan but are considering converting their defined benefit (DB) plans to defined contribution (DC) plans or upgrading their DC plan to a TBP.

The CBA Section supports expanding the availability of the target-benefit model to the federally regulated private-sector and single-employer environments for the policy reasons outlined in the consultation: a strong level of benefit security relative to the DC model; greater predictability of both benefits and contributions; pooling of longevity and investment risks; and flexibility of plan design to enhance sustainability.

While we support the TBP initiative, there is no consensus on their structure. We have made every effort to point out areas which may be controversial and require difficult policy choices.

We have organized our comments according to the headings in the consultation paper.

III. 4.1 ADMINISTRATION AND GOVERNANCE

Introductory Comments

The financial features of the TBP should be decided when the plan is established and incorporated into the constating documents. We support a less prescriptive approach that leaves plan design to be determined by the parties based on the circumstances of the plan. Under this model, the governing body's (i.e., Board of Trustee's) main function is to administer the benefits under the Plan and invest the Plan's assets in accordance with the constating documents and legislative requirements.

A critical aspect of administration and governance is the process for establishing the TBP. There are a number of difficulties in the conversion of an existing pension plan to a TBP, including:

- dealing with unfunded liabilities in existing DB plans, while recognizing that conversion of underfunded DB plans could achieve employee buy-in if the alternative is to switch in the future to a DC plan, group RRSP, DPDPS, Group TFSA or to have no retirement plan at all;
- communication with plan members affected by the conversion that clearly conveys the risk-sharing aspect of the TBP model; and
- negotiations with employees (collectively bargained or otherwise) to reach agreement on a conversion from DB to TBP due to the potential risk to accrued benefits. We expect negotiations will be easier for conversions from DC to TBP.

These difficulties are not insurmountable. The pensions industry has experience with negotiations between non-unionized members and employers in the context of surplus sharing which often lead to agreement. Throughout a conversion negotiation, employers and members have the benefit of their own independent legal advice. Certain aspects of the TBP conversion and ongoing governance processes could be addressed by creating statutory safe harbours or mandatory arbitration to minimize expensive litigation.

The CBA Section believes the legislation should be prescriptive on matters of pure plan administration and portability of TBP benefits. In terms of establishing or converting plans and composition of the governing body, there is no consensus on how prescriptive the legislation should be. The TBP model may not be a practical option for smaller plans because of the costs associated with establishing and administering the plan. We believe that the governance and administration model must be flexible enough to accommodate the creation of multi-employer pension TBPs in order to pool longevity and investment risk and leverage economies of scale. Multi-employer TBPs would promote long-term sustainability as the continuance of the plan would not depend on the existence or participation of a single employer.

Overview of the proposed governance framework

Subject to our comments below, we are of the view that the proposed governance framework is appropriate for private sector and Crown Corporation pension plans wishing to convert to TBPs.

We believe that the main features of the plan (e.g., risk sharing formula, benefits, etc.) should be negotiated (subject to minimum standards in the legislation) and the Board's function should be to implement the terms of the deal within the framework established at the outset.

The Board's functions may include developing and filing the documents that reflect the parties' deal (e.g., plan text, funding document, etc.), working with actuaries to monitor the established

funding targets, and investing the plan assets. The Board should be given the power to establish and implement an appropriate statement of investment powers and procedures (SIPP). The Board is better placed to undertake these activities as it is unlikely that plan members would have the expertise to make complex investment decisions.

While we believe that the terms of the plan should be negotiated during establishment or conversion, variations may be required to plan documentation to smooth transition to this new model. To keep costs low, the system must function efficiently. It may be desirable to incorporate a sponsors committee (analogous to the OMERS Sponsors Corporation[1] structure but on a smaller and more informal scale) into the governance structure to accommodate non-unionized plans and Multi-Employer Pension Plans (MEPPs), provided that safeguards, such as independent advisors, are put in place to ensure plan members are properly represented on the committee. The sponsors committee should be comprised of employer representatives (at the employer's discretion) and representatives of the different member groups, including retirees, and function analogously to that of a union in a unionized context.

The sponsors committee's duties should include authorizing changes to the plan terms (subject to any matters determined to require member consent) and appointing Board members. Obtaining required consent for plan amendments should also be the responsibility of the sponsors committee. To ensure independence from the employer, it is critical for the sponsors committee to have separate advisors from the employer (and the Board of Trustees) with the costs paid for either out of the fund or by the employer. One advantage of having a sponsors committee in the governance structure is the creation of a group of employee (and employer if desired) representatives familiar with the plan and the ability to make more informed decisions on technical matters.

The sponsors committee should be representative of the plan's sponsors. Initially, it could be comprised of the individuals who negotiated the conversion. The plan could set out an election process for replacing the initial members.

Composition of the Board

There are varying levels of support for how prescriptive the composition of the governing body ought to be in the federal legislation. The rationale in favour of prescribing the initial composition of the governance body is that it would provide the relevant parties with an

[1] See http://annualreport2011.sc.omers.com/about-omers/governance-sc

important starting point. Without an initial prescribed composition of the governance body, a significant amount of time and energy will be expended in determining composition and may end in a result that is less desirable than if it were prescribed. There should, however, be a mechanism that allows the prescriptive composition of the governance body to be varied on agreement of the relevant parties. A consent mechanism must be well defined and should include a minimum threshold for consent, including that at least 50% of the board members must be representative of the plan members and retirees.

Those against prescribing the composition of the governing body believe that composition should be determined by the relevant parties. A "one size fits all" approach should be avoided. More flexibility would give employers and members the ability to design a system that works for their particular circumstances. However, a requirement to have at least one independent board member on the governing body should be prescribed.

Whether or not the composition of the Board is prescribed, some of our members recommend requiring independent representation on the Board and a majority of the members with expertise and training appropriate for the administration and investment of pension funds. In a unionized environment, however, others believe the composition of the Board should be left to the parties.

Powers of the Board

We also have different viewpoints here. Some believe that a TBP Board should not have power to amend the plan documents where they refer to the pension plan text and significant policies dealing with funding, contributions, funding deficit recovery and funding surplus utilization. It may be difficult for individual Board members to make decisions that have a direct negative impact on their constituency. The Board of Trustees should be viewed purely as a third-party administrator required to adhere to the plan documents and recommend occasional changes. Plan documents should not be modified without obtaining some form of member consent. If this governance model were adopted, a sponsors committee (or equivalent) would be necessary to avoid unwieldy and costly non-material changes requiring member consent. Plan members would likely not have expertise to vote on adjustments to the funding policy or the investment policy. Material changes could be subject to the consent of the membership at large (including retirees).

Alternatively, some believe it would be appropriate for the Board of Trustees to: have power to amend plan documents provided that at least half the trustees are representative of the

members and retirees; exercise that power in the context of a detailed framework (i.e., the legislation and the plan's constating documents); and have a duty to act in the best interests of all plan members. Boards of MEPPs are regularly asked to make decisions in the best interests of all the members of the plan even though decisions may negatively affect their particular constituency. The conflict of duty could be addressed by a legislative requirement that Board members act in the best interests of all members. For example, the New Brunswick legislation imposes an obligation on a board member "to act independently of the person who appointed him or her."[2] Interestingly, it also states that: "the sole obligation and fiduciary duty of a trustee is to carry out the purposes of the shared risk plan."[3]

A third alternative is to have the Board make recommendations to the sponsors committee for plan amendments. The sponsors committee would have the power to authorize plan amendments subject to a materiality requirement established by the plan terms. This method ensures that plan sponsors have input into amendments in a cost-effective manner and with the assistance of expert advisors as required.

The CBA Section believes that the investment policy should be carved out of the requirement to seek member or sponsor committee approval due to a lack of plan member expertise. The investment function should be left to the Board of Trustees.

The CBA Section agrees that the key to successful TBPs is to set out the various rules in the initial plan documents and to maintain these rules over the long-term. Changes to documents should be rare and only permitted where there are significant problems or where there is broad acceptance by members and retirees.

It is important that the Board establish a conflict of interest policy to ensure that individuals who find themselves in a conflict of interest situation while facing a decision, or regarding their participation in the administration of the plan, would recuse themselves from participating in that decision making process or cease to administer the TBP.

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[2] *Pension Benefits Act* (New Brunswick), s.100.5(2).

[3] *Ibid.*

Plan member support level for significant changes

Some believe different rules should apply depending on the nature of a contemplated plan amendment. For example, technical amendments required for legislative compliance would not require consent of plan members as the plan must be administered in accordance with legislation whether or not it is actually amended.

Others believe that only one set of rules should apply to any amendment of the plan documents, i.e. that an amendment must be approved (or be deemed uncontested and binding if an opposition process is prescribed by legislation) by a significant number of the affected plan members.

Another view is that only amendments to plan documents affecting benefits or contributions should be approved (or deemed uncontested and binding if an opposition process is prescribed by legislation) by a majority or significant majority (for example, at least 66 2/3%) of the affected active members, deferred vested members, retirees and beneficiaries.

Still others believe that the plan terms should dictate which decisions must go to the membership (subject to any statutory minimum standards) and amendments which do not meet the threshold can be authorized by the sponsors committee. The sponsors committee could also be responsible for implementing the member consent process (in whatever form it takes) where required.

The CBA Section as a whole is of the view that any consent or opposition process must be fair and all affected plan members should, at a minimum, have the opportunity to voice their opinions on proposed substantive amendments to the plan documents. If an amendment affects two or more groups of plan members, the prescribed consent or opposition process should apply independently to each group.

The challenge will be to establish an appropriate legislative and regulatory framework determining whether an amendment is approved (or is deemed uncontested and binding) by a sufficient number of affected plan members. Some of our members advocate for a comprehensive set of rules for the consent or opposition process, in both the unionized and non-unionized environments. In a unionized context, the collective bargaining agreement could provide that any plan amendment must have union approval. In such a case, it would not be necessary to obtain the consent of union-represented active members.

Others prefer an approach where the consent process sets certain minimum standards and allows for the negotiation of additional specific details.

If a sponsors committee model is adopted and it is felt that there should be member input on the investment policy, the sponsors committee should be given the task of approving changes to the investment policy. The sponsors committee would be closer to the day-to-day operations of the plan and could also seek expert investment advice if required.

Differences between Governance Structure for Unionized and Non-Unionized Environments

The general governance framework provisions should be the same, regardless of whether the TBP is in a unionized, non-unionized or mixed environment.

For the ongoing operation of the TBP, the differences between these environments will have an impact on the composition of the governing body and on the need for having certain representatives for negotiation purposes.

In a unionized environment, the union can negotiate for its members and should have a representative on the governing body. In a non-unionized environment, representation is required for non-unionized employees. The main difference between the two environments is the method for choosing the non-unionized groups' representatives. A sponsors committee comprised of representatives of employers and members, including unionized and non-unionized members, could be a solution to the logistical problems of appointing members of the governing body.

Unions do not always represent retirees and deferred vested members. These groups may require representation in both unionized and non-unionized environments. A sponsors committee model could appoint these representatives.

Although all these groups ought to be entitled to representatives on the governing body, it should be clearly stated in the legislation that all members of the governing body have a fiduciary duty to act in the best interest of all plan members and beneficiaries (or, as indicated above, a duty to act independently and to carry out the purposes of the plan).

There may be several unions involved, and they may change over time. The framework needs to be sufficiently flexible to allow unions to appoint representatives to the governing body, and to allow the unions to negotiate representation amongst themselves. The governance structure should also be flexible enough to allow multi-employer TBPs to be implemented.

Negotiating Process

The negotiating process may be more difficult for non-unionized employees who are not well organized and may not be sophisticated negotiators. However, the context of surplus sharing agreements offers a precedent for negotiations between employers and members. In the surplus sharing environment, employees have shown to be capable of dealing with complex and sophisticated legal issues and arriving at satisfactory resolutions. Surplus sharing arrangements that end up in court tend to be exceptional cases.

The CBA Section believes that non-unionized employees (as well as unrepresented retirees and deferred vested members in a unionized environment) should be involved in negotiating the initial policies and plan text, and due to the shared risk nature of TBPs, should have some involvement in TBP governance. The key questions to address are who would negotiate on their behalf, and how would that negotiator be chosen?

One approach is to create a sponsors committee, comprised of employer representatives and representatives of the different plan member groups, to negotiate the initial terms of the TBP and then perform certain functions on an ongoing basis.

Some believe that to implement a sponsors committee (or a negotiating committee), legislation should provide for a streamlined process enabling the quick appointment of representatives empowered to negotiate on behalf of all members of the group. Others believe that the process should be left to the parties subject to appropriate minimum standards (e.g., minimum requirements for the composition of the committee). To ensure independence from the employer, the sponsors committee would require its own advisors. Separate independent counsel might be required for certain groups (e.g., retirees).

Another view is that the requirement for the sponsors committee (or negotiating committee) to have independent counsel ensures a fair process without requiring extensive legislation. In many current situations (including litigation and surplus sharing), an ad hoc committee is appointed by the members (or others including the employer in the case of surplus sharing), which instructs counsel. This method has the advantage of being familiar to both employers and member groups.

The involvement of all interested parties at the beginning of the TBP initiative might slow progress. However, it may encourage support for a TBP proposal and could reduce the potential for future disputes.

IV. ADMINISTRATIVE AND GOVERNANCE ISSUES UNDER SECTIONS 4.2 (FUNDING POLICY), 4.3 (CONTRIBUTIONS), 4.4 (BENEFIT STRUCTURE), AND 4.10 (INDIVIDUAL TERMINATION)

While we generally support setting out the framework in the legislation and regulations, subject to certain details being negotiated by the parties and documented in the plan text and governance policies, we have some concerns with this approach.

The more details there are to negotiate, the bigger the risk of delay and disruptions in implementation. Some of our members suggest including default parameters in the initial legislative and regulatory framework which would allow for the establishment of the TBP without the need to negotiate the initial terms of the plan. The interested parties would be free to negotiate changes to the defaults either before or after the plan is established.

Others believe that the parties should settle the plan terms at the outset and be free to negotiate a plan suitable for the situation even if the process is time-consuming. Time frames could be included in the legislation to ensure the process moves forward. The legislation could build in a dispute resolution mechanism to deal with stalled negotiations and other disputes that may arise over the life of the plan.

We have several specific administrative and governance concerns.

Section 4.2 - Funding Policy

The consultation proposes a general requirement for the plan administrator to establish a funding policy for the TBP which must be submitted to OSFI. We agree with this approach, provided the Board is simply implementing the deal negotiated by the relevant parties.

In particular, if the margin or the probability test is not prescribed by legislation, it should be determined by the parties as part of the negotiation of the plan terms. The Board could have the responsibility of creating the funding document within parameters agreed to by the parties.

Some believe that regardless of the approach chosen for the framework, margin or probability test, an approach with a well-defined methodology based on the Canadian Institute of Actuaries (CIA) Standards of Practice is preferable. The rationale for adopting a more prescriptive approach is that it should result in fewer disputes and facilitate the work of the governing body. Others believe that in a unionized environment the legislation should be less prescriptive and allow the parties to set the terms.

Section 4.3 - Contributions

The CBA Section agrees that the contribution rules must be clear from the start. Consistent and predictable long-term contributions are necessary for the proper governance and administration of TBPs and should be a guiding principle in the development of the legislation.

Leaving too many matters to be negotiated may stall negotiations. Giving interested parties the ability to negotiate changes to contribution rates (e.g., when new collective agreements are negotiated) could create problems for the governing body, especially where contributions are reduced. If the variable contribution method is permitted, it would be wise to prescribe a minimum target contribution plus minimum trigger levels with options for more stringent requirements to be set by the governing body or through the negotiation process between interested parties. Where triggers affecting contribution levels may be set by the governing body, well defined disclosure requirements may be necessary to fully inform contributing plan members and the employer.

Other members believe that the legislation should prescribe the items that must be addressed in the plan but should leave negotiation of the details to the parties, subject to any statutory minimum standards.

Section 4.4 - Benefit Structure

The base/ancillary benefit description should be defined in the plan text and, subject to amendment, through negotiation of the interested parties at a later date as circumstances dictate. This would allow each plan to reflect its unique circumstances from the start without the need for further negotiations immediately following the establishment of the plan, and will facilitate the work of the governing body.

Section 4.10 – Individual Termination

While it is intuitive for the individual termination value to reflect the funded ratio of the plan at the time of termination, the potential interval between the last valuation and the date of termination may give rise to disputes, depending on the frequency of the valuations,. In particular, valuations on a triennial basis raise the potential for disputes for underpayments or overpayments, which can be an ongoing source of difficulty for the governing body.

Different methodologies should be considered to address the potential for underpayments and overpayments to terminating plan members. We propose two possible solutions:

(i) by staggering the payment of the termination value so that a portion is withheld, as a contingency, which can be released after the next plan valuation; or

(ii) the benefits of the terminating plan member must be determined by multiplying the value of their accrued benefits by the plan's solvency ratio which must be determined at the end of every fiscal year. The most appropriate methodology for each TBP could be incorporated in the plan text or adopted as a policy by the governing body. This is currently the practice in Quebec for member-funded pension plans.

The term "surplus" should not be used in the context of an ongoing TBP because it is misleading to participants and inconsistent with the shared risk nature of the TBP. Some of our members believe that if the TBP is in an excess position, no excess should be allocated as part of the Termination Value. Excess assets are designed to be used to enhance benefits and act as an additional cushion during hard times. This principle should be incorporated into the legislative and regulatory framework and the governing body should have no power to vary it, nor should the parties be free to change this principle through negotiation.

Others believe that the treatment of excess assets should be negotiated by the parties and the parties should be able to agree to the allocation of excess on termination.

We agree that under no circumstances should any surplus at any time revert to the employers.

V. 4.2 FUNDING POLICY

Is the going concern valuation sufficient to measure and fund target benefits?

There are differing viewpoints on this issue.

Some of our members believe it is essential to incorporate margins into the funding of TBPs. Others do not believe incorporating margins should be mandatory.

Some of our members believe that benefit increases should only be allowed once assets exceed going concern liabilities plus a prescribed margin. Others do not agree with a mandatory approach.

Whichever test is adopted, the affordability testing should be well-defined. This approach should take into account the long-term perspective of the plan while giving the plan administrator the information required to take corrective action before the plan is in difficulty.

In light of the nature of TBPs, plan beneficiaries should get regular going-concern and solvency valuation summaries as part of a plan's disclosure requirements.

Which approach should be adopted under the federal legislative and regulatory framework: the margin or the probability test?

Similarly, we do not favour one approach over the other. In choosing, the following considerations should be taken into account.

From an employer's perspective, the margin approach appears easier to communicate to employees and less costly to implement. However, from an employee's perspective, the probability test approach may be easier to grasp and preferable overall, especially where a high probability of delivery is allocated to base and a somewhat lesser probability of delivery to ancillary benefits, as was done in New Brunswick.

Based on our current understanding, the Provision for Adverse Deviation (PfAD) approach can take into account asset allocations, applicable discount rates, plan maturity and PfAD offsets (e.g., contribution increases previously agreed to via collective bargaining), all of which is similar to the Alberta TBP proposal and the Quebec PfAD that must be calculated on a solvency basis.

In appropriate circumstances, interested parties should be permitted by legislation to agree to a PfAD which exceeds the minimum required, should that be desired.

Regardless of the approach chosen, some of our members believe that an approach with a well-defined methodology based on CIA Standards of Practice is preferable. Others believe that in a unionized environment, the parties should be able to agree on the funding methodology.

Is the PfAD approach appropriate as a funding margin or should a different margin calculation be provided for or allowed (e.g., through a discount rate margin)?

The PfAD approach may be appropriate so long as there is a required minimum PfAD which must be calculated by an actuary in accordance with CIA Standards of Practice, subject to applicable legislation, regulations and OSFI Directives. However, explicit reserves should be considered because they are more transparent to all parties and provide more useful information for the evaluation of TBP affordability. A discount rate margin could be acceptable but it is suggested that the actuary disclose the PfAD explicitly, generally as a percentage of plan liabilities.

Regardless of the approach chosen, we prefer a well-defined methodology based on CIA Standards of Practice.

What is the appropriate time horizon for the purposes of calculating the Provision for Adverse Deviation (PfAD)?

Some members believe that, in light of the nature of TBPs, it is advisable to incorporate margins into their funding. Others believe that the current model in MEPPs, which does not require a margin, works well and a margin should not be mandated.

The PfAD would initially be calculated by the plan actuary when the plan is first established and would be built-up over time as the plan operates.

How frequently should valuations be required?

The following should be considered for valuation frequency:

- Annual valuations should be required for TBPs with PfADs or funding margins that fall below a prescribed minimum threshold.
- Triennial valuations should be required for TBPs with PfADs or funding margins at or above a prescribed minimum threshold.
- Interested parties should be free to negotiate more frequent TBP valuations, if desired.
- The governing body should have the discretion to order a valuation at any time.
- OSFI should have the power to order a TBP valuation at any time.

Should some of the specifics on the funding policy (e.g., PfAD rates) rely on guidance from sources such as the CIA or should they be more fully prescribed in legislation or regulations?

If the PfAD model is adopted, it is our understanding that an actuary will be required to determine applicable PfAD rates in accordance with CIA Standards of Practice. Specifics on the funding policy, such as the PfAD rate, should rely on guidance from sources such as the CIA, rather than being fully prescribed. Some of our members believe that this approach is desirable because of the lack of TBP funding experience in Canada and recognition that it will require significant funding flexibility at the outset. A more prescriptive approach, should one be desired, should be delayed until we have greater experience with TBP funding. Other members point out that the TBP MEPP model has existed for many years, Canada has decades of experience with them, and MEPPs should serve as a model for the structuring of the TBP.

VI. 4.3 CONTRIBUTIONS

The TBP is designed to operate with fixed contributions. The parties should establish the predetermined contributions. Any variation in contributions should be pre-established and any amendments outside the permitted range be on an exceptional basis only. Contribution increases should be allowed provided the range is limited and prescribed or determined by the parties. In addition, intergenerational equity must be taken into account especially when members' contributions are increased to fund deficits. This may create inadvertent discrimination against younger members of the plan.

The parties should decide the priority order of contribution increases or benefit reductions. For example, the parties may decide that, before reducing benefits, employer and employee contributions should be increased up to a maximum predetermined amount. This should be a mandatory first step before cutting benefits. A cap on the variability level of employee and employer contributions should be pre-established. The employer and employee variability would not need to be equal. The same triggers should apply for contribution increases and benefit reductions.

VII. 4.4 BENEFIT STRUCTURE

We believe that the approach of categorizing benefits in two classes is the only method to prioritize the order of benefit reductions. For this purpose, the categories of base and ancillary benefits should be prescribed in federal legislation or regulations to ensure consistent treatment amongst all TBPs. Ancillary benefits should be reduced before reducing or modifying the basis benefits. The latter should be well protected and only reduced as a last resort.

The order of benefit reduction should not be prescribed but left to be determined by the parties in the constating documents. The legislation should be drafted liberally to establish the framework for benefit reductions in the benefit and funding policy or in the TBP text.

VIII. 4.5 FUNDING DEFICIT RECOVERY PLAN

The CBA Section recommends that the required deficit recovery measures regulations not be overly prescriptive. However, as indicated above, base benefit reductions should be a last resort (last stop in priorities).

In general, deficit recovery measures and their prioritization should be required to be set out in the plan's constating documents. This will enable plan sponsors, members and retirees to

establish recovery mechanisms and priorities suitable for the plan, taking into account the plan demographics and other relevant factors. We suggest, however, that the regulations ensure any measures taken to implement a deficit recovery program (which could include contribution increases or benefit reductions) treat the different membership classes fair and equitably reflecting the circumstances of the plan and minimizing intergenerational and inter-cohort subsidies.

The CBA Section does not take a position on whether the PfAD or probability test would be preferable. We would support requiring the Board to implement the deficit recovery plan as soon as the threshold funding measure is not satisfied. However, the degree to which the recovery measures must be implemented could reflect the level of the shortfall (e.g., it could be proportional to the shortfall).

IX. 4.6 FUNDING SURPLUS UTILIZATION PLAN

Similar to our comments on Section 4.5, we recommend that the surplus utilization measures regulations not be overly prescriptive. Stakeholders should have considerable flexibility in determining the specifics of a surplus utilization plan when the TBP is established and should be set out at the beginning of the constating documents. However, the surplus utilization plan should work in tandem with the funding deficit recovery plan so that the surplus must first be applied to reverse any reductions previously implemented under a funding deficit recovery plan. The regulations should ensure that measures taken in implementing a surplus utilization plan benefit the different membership classes fairly and equitably.

Regardless of whether the PfAD measure or probability test is adopted for funding purposes, the CBA Section believes the regulations should permit the plan to use surplus assets above the threshold margin (i.e., 100% of the target funding level including the PfAD, or 100% of the target funding level based on the probability test, as applicable), subject to any restrictions that may apply under the surplus utilization plan. The regulations should specify minimum timeframes (e.g. three years) that surplus may be applied or amortized, to avoid rapid depletion of surplus.

X. 4.7 DISCLOSURE AND COMMUNICATIONS

Clear communication to stakeholders is a critical component of the TBP model. In our experience, plan members tend to disregard long, technical pension communications. The

plan administrator must balance the competing needs for comprehensiveness and comprehensibility (i.e. plain language and brevity) in communications. We recommend that the administrator be required to put in place a communication policy. This may be implied in the requirement to file details of communication material the administrator plans to provide to members and retirees regarding the risk sharing characteristics of the plan.

We agree with the approach of building on and expanding the disclosure requirements in the PBSA for ongoing disclosure relating to the plan. We also agree with the proposed filing requirements.

The plan sponsor(s) should be notified of any changes before disclosure to the plan members. This permits the plan sponsor(s) to implement any required changes to its systems and to brief its staff.

Timing for notices to members of changes in the documents should be flexible. One possibility is for the notices to be built in through a prescribed notice period. The notice period could be shortened on application to OSFI by the plan administrator. Retirees and members (active and deferred) should receive annual statements of the financial status of the plan. Members need to be aware of the risks associated with their plan at a given time, whether communicated through disclosure of the plan's solvency funding ratio plan in the administrator's annual reports or other means.

Additional disclosure to members requires the sponsor to provide the web address of the Financial Consumer Agency of Canada (FCAC) prior to converting to the TBP. This is conceptually different from the ongoing disclosure obligations. In a unionized environment, the union would assume responsibility for negotiating with employers. After the initial communication by the employer, the union would communicate with the members. In a non-unionized environment, there must be a process to create a negotiating committee able to organize itself and obtain counsel. We envision the negotiating committee assuming responsibility for communications with its constituents throughout the negotiation process. Once the Board is formed, it would assume responsibility for ongoing communications and filings.

XI. 4.8 CONVERSION OF PENSION PLANS TO TARGET BENEFIT PLANS

The conversion of DB benefits to a TBP format implies some loss of benefit security, for two reasons: solvency funding generally provides more benefit security than going-concern funding in today's environment of low interest rates; and the employer would no longer underwrite funding shortfalls post-conversion. Loss of benefit security would be proportionate to liabilities converted (i.e. increasing as liabilities converted increase). At a minimum, loss of security should be communicated in a comprehensible format to members and retirees.

The consultation paper suggests that conversion of a DB plan to a TBP would require consent from employees and retirees. The interests of retirees and active members can differ substantially. Active members, particularly those with less accrued benefits, may consent to conversion to a TBP if the alternative were wind up of the DB plan or conversion to a DC plan. Properly informed, retirees and active members with significant accrued benefits would not be expected to consent to a DB-TBP conversion because they would have little to gain and a potential for loss. We suggest that any requirement to obtain consent from active members and retirees with significant accrued benefits be polled separately from those without.

If the legislative goal is to facilitate conversion of accrued benefits to a TB format other than by unilateral action of a DB plan sponsor, conversions should only be able to proceed with informed consent. It is important that members and retirees fully understand the impact of the conversion and the risks they would assume. Where active members are represented by a union, the union could consent on behalf of the active members. In the case of retirees and non-unionized employees, consent should be obtained individually. Some CBA Section members believe that it should not be possible to remove a member's right to a guaranteed DB pension without their express consent. Others believe that a prescribed negative regime would be sufficient (i.e. the plan would convert if no more than 1/3 of the members object). If consent from all members is required, it triggers a dilemma: how can accrued DB entitlements be converted to a TBP format such that properly informed late-career and retired employees would consent to the conversion? A possible solution is to require that accrued benefits be calculated without recourse to any reduction at the time of conversion.

Other members of the CBA Section prefer a contractual approach based on informed negotiation and consent. Parties to contractual arrangements can change those arrangements when circumstances require. TBP legislation could facilitate an offer of consideration in

exchange for consent to convert accrued benefits. Examples of how to structure TBP legislation to achieve consent to conversion of DB entitlements could include one or more of the following:

Consideration	Benefit to Member or Retiree
Annuity buy-outs for all or part of accrued benefits	Increases benefit security through elimination of sponsor insolvency risk
Lump-sum cash incentive payments in amounts representing some portion of the value of increased risk	Provides immediate income benefit – similar to a surplus-sharing deal
One-time benefit improvement and/or salary adjustment	Provides immediate income benefit – similar to a surplus-sharing deal
Increased paid-vacation or sick-day allowance	Increases value of non-cash compensation
Improvement to non-pension benefit coverage (e.g. flex account, health, medical, dental or insurance coverage with obligation to maintain changes for a certain period	Increases value of non-cash compensation or benefits
Increased/new employee discounts on employer products or services (where feasible)	Increases value of non-cash compensation or benefits
Offer wellness programs, such as a gym or babysitting services at the employer's location	Provides immediate income benefit – similar to a surplus-sharing deal without taxable benefits for the employee

Conceptually, it is possible to express in actuarial terms (as a dollar amount) the difference in value of a benefit funded on a solvency basis in a DB plan and a benefit funded on some other basis in a TBP. Performing a calculation for each plan member or retiree when a conversion is proposed would facilitate both understanding the risks and negotiation of their acceptance by plan members and retirees in exchange for some type of consideration. We do not believe it is necessary to include an exhaustive list of possible consideration for consent in the legislation.

A legislative regime for conversions based on informed negotiation would reduce the necessity to prescribe a restrictive regime for funding and investment policies designed to reduce the risk of benefit reductions. A conversion regime could allow more flexibility of plan design and selection of funding and investment policies that are consistent with generally-accepted actuarial principles and with the "prudent person" standard that has become the normative guideline for selecting pension investments and monitoring their performance.

Any future rules should facilitate the ability of DC plans to convert to TBPs. As in the case of DB plans, if a consent regime is adopted, the same considerations as discussed above apply. The actuarial value of a member's TBP entitlements should not be less than the market value of the member's DC assets at the time of conversion.

The legislation should take into account administrative issues that plan administrators may face following a conversion, such as the continuity of beneficiary designations. The legislation should state that there is continuity of the beneficiary designation after the conversion unless the member informs the administrator of a change in prescribed form.

XII. 4.9 PORTABILITY AND LOCKING-IN RULES

We do not see any TBP-specific issues with locking-in. Locking-in is an important principle of pension regulation. We question whether the PBSA's 50% unlocking rules will apply to TBPs.

For portability, the conditions for a transfer out of a TBP, and the options available on a transfer should follow the current PBSA model. However, due to the nature of TBPs and the ability to reduce accrued benefits in a TBP, the calculation of the transferring member's pension benefit credit will require specific regulations.

TBP legislation must address the impact of excess amounts and deficits. For deficits, assuming the member's pension benefit credit is calculated at the last day the member participated in the TBP, how would a reduction of accrued benefits affect a member who has transferred their pension benefit credit from the plan? For example, if a member participated in a TBP until December 31, 2018 and notifies the plan administrator within 90 days of the cessation of their plan membership and their election to transfer their pension benefit (as required in PBSA s. 26(1)), and the plan administrator gives effect to that transfer in accordance with the PBSA, how will a future amendment to the TBP to reduce accrued benefits effective on a date prior to December 31, 2018) affect the member's transfer? The legislation must incorporate a process for transfers that addresses excess and deficits. To reduce uncertainty in plan administration, the legislation should be prescriptive under these scenarios.

To promote the accumulation of greater benefits, it may be desirable to require the administrator of a TBP to accept a transfer from another TBP (or MEPP).

XIII. 4.11 PLAN TERMINATION AND WIND-UP

We support including an anti-avoidance provision in the legislation to prevent plan sponsors from converting plans solely to get around current funding obligations related to a DB plan. However, plans that are not currently subject to a solvency funding standard (e.g., negotiated MEPPs) should not be required to comply with a more onerous standard on wind-up.

XIV. 4.12 APPLICATION TO MULTI-EMPLOYER PLANS

Many elements of the proposed federal TBP framework already apply to federal MEPPs and specifically negotiated defined benefit plans such as negotiated contributions, target rather than defined benefits, and the use of benefit reductions as a mechanism for addressing funding deficiencies under the plan. MEPPs are currently a form of "target benefit plan". However, MEPPs have considerable flexibility in governance and plan design to address funding deficiencies. We have focused on the proposed elements of the TBP framework that do not currently apply to federal MEPPs.

It is not clear from the consultation paper whether legislation would encourage existing MEPPs to convert to the TBP framework. We generally support the conversion. However, separate TBP rules must be tailored for the unique characteristics of this type of plan.

While some aspects of the proposed TBP framework would be appealing for existing MEPPs, other aspects may discourage conversion.

The funding rules tailored to plans which provide target benefits rather than a defined benefit may be appealing for existing MEPPs. Currently, while employers are exempt from funding on a solvency basis, MEPPs are subject to the solvency funding requirements, which reduces the ability for the administrator to deal with deficiencies. The consultation paper suggests that solvency funding is not necessary in the federal TBP context since entitlements depend on the financial situation of the plan. This also applies in the case of MEPPs. Similarly, MEPPs do not carry the same level of risk associated with the insolvency of a single employer pension plan. The proposed TBP exemption from solvency funding would be appealing to and appropriate for MEPPs. Another attractive feature of the TBP model is a regulatory framework for some aspects of the plan administration, including treatment of individual terminations and determination of transfer values for plans which pay target benefits rather than defined benefits.

On the other hand, the requirement of a highly-prescriptive governance structure (including a prescriptive deficit recovery plan and surplus utilization plan), as well as the funding requirements on conversion in the TBP framework may not be appealing for existing MEPPs. In contrast to the proposed TBP framework, MEPPs currently have considerable flexibility in areas such as governance (including board of trustee representation) and the ability to address funding deficits and utilize funding surpluses. A framework that reduces flexibility would likely be a deterrent for MEPPs considering conversion to a TBP or for newly established plans choosing between the traditional MEPP model and the proposed TBP model. In addition, MEPPs that convert to the TBP framework would be required to ensure the plan is fully funded on a going-concern basis at or near the time of conversion. For MEPPs that are underfunded on a going-concern basis, this would mean reductions to benefits or additional funding on conversion which may be a disincentive to converting. The consultation paper appears to require MEPPs that convert to the TBP framework to continue funding on a solvency basis for five years following conversion. This would be a disincentive to converting any MEPP that has a significant funding deficiency on a solvency basis.

We believe the legislation should reflect the fact that MEPPs already have many features of a TBP by recognizing certain aspects of the governance structure of the MEPP as equivalent to the proposed requirements for single employer plans. The proposed anti-avoidance mechanism which is intended to serve as a deterrent to single employer plans who seek to use conversion to avoid its funding obligations should not apply in the context of a MEPP.

XV. CONCLUSION

The CBA Section supports TBPs and commends the government for initiating the process for their establishment. We trust that our comments are helpful in guiding the government through the development of a TBP framework.

The CBA Section is thankful for the opportunity to provide comments and would be happy to answer any questions that stem from our submissions. We would be pleased to assist the government in any way possible in the development of TBPs.