THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

Proposed Changes to Funding and Asset Allocation Rules for Multi-Jurisdictional Pension Plans

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PENSIONS AND BENEFITS LAW SECTION

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PREFACE

The Canadian Bar Association is a national association representing 36,000 jurists, including lawyers, 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 CBA Pensions and Benefits Law Section, with assistance from the Legislation and Law Reform Directorate at the CBA office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the CBA Pensions and Benefits Law Section.

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I. INTRODUCTION

The Pensions and Benefits Law Section of the Canadian Bar Association (CBA Section) is pleased to comment on proposed changes to the funding and asset allocation rules for multi-jurisdictional pension plans, which were published in the July 2017 Consultation Paper.[1]

The CBA is a national association representing over 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. We promote the rule of law, access to justice, effective law reform and provide expertise on how the law touches the lives of Canadians every day. The CBA Section contributes to national policy, reviews developing pension and benefits legislation and promotes harmonization. We have members involved in pensions and benefits law across the country, including counsel who advise pension and benefit plan administrators, employers, unions, employees and employee groups, trust and insurance companies, pension and benefit consultants, and investment managers and advisors.

The CBA Section commends the Canadian Association of Pension Supervisory Authorities' (CAPSA) continuing efforts to address important pension plan funding issues for multi-jurisdictional pension plans. We have long advocated for the harmonization of pension legislation across Canada, and these proposed changes are a positive step forward from this perspective. We also appreciate CAPSA seeking input from pension industry stakeholders on proposed legislative changes.

Our comments on the questions for consideration in the Consultation Paper are below.

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1 *See* Canadian Association of Pension Supervisory Authorities, *Consultation Paper on Proposed Changes to Funding and Asset Allocation Rules Under a Future Agreement Respecting Multi-jurisdictional Pension Plans* (July 2017), available online (http://ow.ly/EXS830eOCwK).

II. RESPONSES TO QUESTIONS FOR CONSIDERATION

Question 1 – Is one option described in the Consultation Paper preferable to the other? If so, which one and why?

Option 1 (Major Authority Focus) is preferable to Option 2.

The CBA Section agrees that Option 1 is simpler for multi-jurisdictional pension plans in Canada to implement and administer, and is consistent with the goal of harmonizing pension benefits standards across Canada. Option 1 also broadly reflects the current rules under the 2016 agreement, which is familiar to the pension industry.[2] We expect that it would be less costly than Option 2 for plans to implement and administer.

The CBA Section acknowledges that Option 1 could result in a situation where plan members' benefits are funded differently than would be required by their home jurisdiction. For example, where a pension plan is registered with a major authority that does not require defined benefits to be solvency funded, plan members employed in a jurisdiction that does require solvency funding would have their defined benefits funded at a different (potentially much different) level than if the plan were subject to their own jurisdiction's funding rules. In catastrophic circumstances, where the plan did not have sufficient assets to fully fund its benefits on wind-up, and the employer was insolvent, plan members outside the major authority's jurisdiction could be worse off than if the plan were subject to their own jurisdiction's funding rules.

In our view, however, as a general principle, it is more important to treat members of the same plan in the same way, regardless of jurisdiction – this is both desirable and defensible. In our experience as advisors, it is disruptive, difficult to explain, and difficult for members to understand why their pension benefits are dramatically different from those of a colleague in an otherwise identical position. This is particularly true when full benefits are in jeopardy due to an insolvent wind-up. In those circumstances, it is preferable that all members have the same level of benefit security. This issue is mitigated by the fact that regimes that have or will dispense with solvency funding are balancing with other more robust, going-concern funding requirements. In our view, the situations under which members' benefits differ based on their jurisdiction of employment should be reduced rather than expanded given the complexity these differences impose.

2 *See* Canadian Association of Pension Supervisory Authorities, 2016 Agreement Respecting Multi-Jurisdictional Pension Plans (May 2017), available online (http://ow.ly/Ijtj30eOCJn).

Some jurisdictions are moving away from solvency funding. One of the effects of Option 2 would be to require solvency funding to be implemented for multi-jurisdictional plan members in those jurisdictions that have moved away from it, contrary to the will of that jurisdiction's legislature. If Option 2 is adopted, these jurisdictions may not wish to sign on to the Future Agreement, which may make the implementation of Option 2 problematic unless legislative changes are made. This could create more complexity and more delay.

We acknowledge possible concerns that existing defined benefit plans may engage in "forum shopping" to register their plans in the "most favourable" jurisdictions for funding requirements. We have not seen evidence of this behaviour to date, and shifting the plurality of members in an existing plan would likely not be easy. If forum shopping is a concern, the agreement can include a deterrence mechanism.

Question 2 – Are there advantages and disadvantages to either option that have not been described in the Consultation Paper? If so, what are they?

Another advantage of Option 1 relates to funding arrangements that may be particular to certain jurisdictions, such as solvency reserve accounts. Option 1 would avoid potential complexities in the determination of allocation of assets and liabilities for these arrangements. For example, under Option 2, for solvency reserve accounts, questions would include whether the 105% solvency liability threshold to withdraw funds would have to be met for each jurisdiction after taking into account minor authority adjustments as well as how withdrawn assets would be allocated. More complexities could arise with any future developments not applicable in all jurisdictions.

Question 3 – Is one method described in the Consultation Paper for addressing defined benefits that generate significant funding costs when valued and funded on a solvency basis, but lower funding costs when valued and funded on a going concern basis, preferable to the other? If so, which one and why?

The CBA Section's view is that Method 2 (modifying proposed asset allocation rules), described on page 8 of the Consultation Paper would be preferable to Method 1 (modifying proposed funding rules).

Method 2 is more consistent with our comments on the preferred method for the proposed funding rules. While Method 1 would not require any modification of the proposed asset allocation rules, it would require modification of the proposed funding rules.

The future asset allocation rules will apply only when a major plan event occurs, which could very well happen only once every several years. We believe that the future asset allocation rules should interfere as little as possible with the key elements of the future funding rules.

Considering, among other things, the number of multi-jurisdictional defined benefit pension plans registered either in Ontario or Quebec, and the choice recently made by Quebec and announced by Ontario on solvency funding, Method 1 would put too much emphasis on a funding basis – from which many jurisdictions are either moving away or granting exemptions or temporary reliefs.

Finally, Method 2 seems to be more equitable for all plan members when a major plan event occurs. Here, we believe it is preferable that, under the future asset allocation rules, all members of the same plan be treated the same way by first allocating the plan assets to cover higher priority benefit liabilities for all plan members. Plan assets should only be allocated to ancillary benefits (to the extent that they apply) after all base benefit liabilities have been funded.

Question 4 – Are there other options and methods that CAPSA should consider for the multi-jurisdictional pension plan funding and asset allocation rules under the Future Agreement?

The CBA Section has also identified two matters that should be considered by CAPSA for the Future Agreement: commuted value transfers for Quebec members and target benefit multi-employer plans.

A. Commuted Value Transfers for Quebec Members

The CBA Section notes a potential issue with paragraph 6(f) of Schedule B of the 2016 Agreement on the funding of ongoing pension plans. That paragraph stipulates that the pension legislation of the major authority applies to the restrictions on the amount of the commuted value that may be transferred out of the pension plan where the plan is not fully funded on a solvency or going concern basis.

Quebec amended its pension legislation to modify, among other things, several of its funding rules – including the rules that apply to the transfer of commuted values where the plan is not fully funded. More specifically, in cases where Quebec plan members cease active membership and voluntarily exercise portability, their commuted value must be paid in proportion to the plan's solvency ratio, without any residual benefits to be funded and paid by the employer (unless the plan specifically provides for the payment of the residual benefits). Prior to this change, any residual benefits had to be funded and paid by the employer in accordance with the rules and limits set out in the Quebec pension legislation.

The new rule in Quebec is different from the one that generally applies in other jurisdictions. As currently drafted, paragraph 6(f) of the 2016 Agreement is not entirely clear as to its scope. For example, based on the current language of this paragraph, could someone argue that the new Quebec rule will apply to non-Quebec members where a multi-jurisdictional pension plan is registered in Quebec?

Our understanding from our discussion on April 3, 2017 with CAPSA's representatives is that this is not the intent of paragraph 6(f), and that the new Quebec rule will only apply to the Quebec members of the plan (since the new rule governs a plan member's entitlement). Clarifying paragraph 6(f) in the Future Agreement would avoid any potential ambiguity or issue with respect to the scope of this paragraph.

B. Target Benefit Multi-Employer Plans

Neither the current Agreement nor the proposed Future Agreement addresses the unique situations, special rules and considerations for target benefit multi-employer plans, where the employers' only funding obligation is to provide fixed contributions.

Under the current Agreement, members in provinces that recognize target-benefit plans receive the going-concern funded level of their benefits, while members in provinces that do not recognize target-benefit plans receive 100% of the solvency value of their benefits. Paying former members of a plan funded only on a going-concern basis the full solvency value of their benefits is illogical. It results in these former members receiving more than former members from other provinces, and more than they would have received had the plan been terminated.

It would be useful for the next version of the Agreement to provide separate rules for the funding of target-benefit, multi-employer plans, and how the assets of these plans will be allocated on the occurrence of a major plan event. Having separate target-benefit sections would permit the Agreement to recognize both the unique nature of these plans, and how the allocation of risk between employers and members in those plans differs from traditional single employer defined benefit plans. Section 12 of the Agreement already contains a separate allocation scheme for a very small subset of multi-employer plans.

It would also be desirable for the next version of the Agreement to provide that the funding requirements of the major authority (and only those funding requirements) apply to the benefits of all members of target-benefit, multi-employer pension plans, regardless of their jurisdiction of employment. It should also make all members of target-benefit, multi-employer pension plans, regardless of their jurisdiction of employment, subject to the benefit entitlement legislation of the major authority. These provisions would eliminate the current unfairness which arises when former members of a multi-jurisdictional target-benefit multi-employer plan elect to transfer their benefits out of the plan.

III. CONCLUSION

The CBA Section appreciates CAPSA's continuing efforts to address important pension plan funding issues for multi-jurisdictional plans. The proposed changes to the funding and asset allocation rules for multi-jurisdictional pension plans are a positive step towards the harmonization of pension legislation across Canada. We trust that our comments are helpful, and look forward to the opportunity for continued participation in CAPSA's pension consultations.