THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

July 13, 2018

Via email: lynn.hemmings@canada.ca

Ms. Lynn Hemmings
Senior Director, Financial Sector Division,
Financial Sector Policy Branch
Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5

Dear Ms. Hemmings:

Re: Solvency Funding Considerations

The Canadian Bar Association Pensions and Benefits Section (CBA Section) is pleased to comment on approaches to solvency funding. When we met with you in fall 2017, you invited us to share our perspective as it relates to a federal framework.

The CBA is a national association of over 36,000 members, including lawyers, notaries, academics and students across Canada, with a mandate to seek improvements in the law and the administration of justice. The CBA Section contributes to national policy, reviews developing pensions and benefits legislation and promotes harmonization. Our members are involved in all aspects of pensions and benefits law, including counsel who advise plan administrators, employers, unions, employees and employee groups, trust and insurance companies, pension and benefit consultants, and investment managers and advisors.

Guiding Principles

The CBA Section believes that, as a policy objective, Finance Canada should support a sustainable framework and measures to strengthen pension coverage that take into consideration the interests of various stakeholders. Our members have different views as to whether this policy objective could be achieved by modifying the current solvency funding requirements applicable to federally registered defined benefit (DB) pension plans.

That said, the CBA Section urges Finance Canada to consider three principles when contemplating potential changes to the funding model:

- Retirement Income Security – pension issues are of national importance and improving the funding and security of pension benefits will advance the objective of facilitating a reliable retirement savings system for Canadians;

- Sustainability – the solvency funding framework should be designed to be manageable in the long term, and fair and equitable to all stakeholders; and
- Harmonization – any changes should align with the direction taken by provinces that have already undergone solvency funding reforms.

We also believe that a regulatory framework for target benefit plans as well as solvency reserve accounts should be viewed as offering an additional option for pension plan design, and not as a solution for concerns with the long term sustainability and viability of DB pension plans.

Retirement Income Security

As stated in the CBA's 2010 resolution on *Funding and Security of Pension Benefits*[1], the CBA Section believes that promoting retirement income security is an important function of government. We urge governments to support and promote reasonable measures that increase the funding and security of pension benefits, and appropriately consider the impact of such measures on pension plan sponsors, pension plan members and other stakeholders.

Sustainability

The solvency funding framework must be designed in a way that is manageable and sustainable in the long term, and be fair and equitable to all stakeholders in all economic environments. Further, there should be sufficient flexibility in the solvency funding regime to provide the necessary counterbalances to economic shifts without the need for further temporary relief measures.

Solvency funding relief for federally registered DB plans was made available, on a temporary basis, following the 2008 market downturn. Chronically low long term interest rates since the market downturn contributed to weakening plans' solvency positions in some cases. Responses to date have been *ad hoc* and reactive, and no new temporary solvency funding relief has been introduced since the *Solvency Funding Relief Regulations, 2009* (except in respect of specific plans).

The Distressed Pension Plan Workout Scheme was added to the *Pension Benefits Standards Act, 1985* in 2010, followed by regulations enacted in 2011. We understand that the scheme has not been widely used, with possible obstacles including the requirement to have court-appointed representatives and a formal negotiation. Finance Canada might consider the appropriateness of new temporary solvency funding relief measures to help ensure the sustainability of existing DB plans until permanent changes to the solvency funding framework have been made. This would be weighed against the desire to maintain existing funding requirements. If adopted, temporary insolvency relief would help to ease the pressure on employers for further closures/terminations of DB plans before a new solvency funding framework is available. This approach has been adopted in some other jurisdictions that have proposed solvency funding reforms, most recently in Ontario.

Harmonization

All stakeholders will benefit from an efficient and effective pension regulatory system in Canada and harmonizing pension legislation is key to facilitating that system. The CBA Section has long advocated for harmonization of pension legislation across Canada.[2] We highlight the need for, and

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1 See Canadian Bar Association, Resolution 10-02-M Funding and Security of Pension Benefits (February 13, 2010), available online (https://bit.ly/2KRVK1H)

2 See for example, Canadian Bar Association, Resolution 10-01-M Harmonization of Pension Laws (February 13, 2010), available online (https://bit.ly/2MUvt3C)

the inherent fairness in, having rules across Canadian jurisdictions that are as harmonized as possible, particularly on funding.

The Canadian jurisdictions that have introduced (or proposed) solvency funding reforms have taken somewhat different paths:

- The approach in Alberta and British Columbia preserves solvency funding requirements, but provides for solvency reserve accounts to allow withdrawal of actuarial excess or surplus if certain conditions are met. Despite preserving solvency funding, both jurisdictions have continued to provide forms of temporary solvency relief.[3]
- Québec has eliminated the requirement for solvency funding for most ongoing plans altogether, but with the corollary introduction of a strengthened going concern model which includes a new stabilization provision related to the investment policy as well as accompanying changes to the rules governing portability and surplus rights.
- Ontario recently reduced the solvency funding target for DB plans to 85% of solvency liabilities. This was coupled with a new requirement to establish a funding reserve in the plan and a shortened amortization period for funding a going concern shortfall.
- Other jurisdictions (e.g., Manitoba, Nova Scotia) have released consultation papers seeking input on matters including solvency funding reforms. The possible reforms under discussion include changes similar to those introduced in Ontario.

If the federal rules deviate from these approaches, it would further exacerbate this patchwork of funding rules.

The Canadian Association of Pension Supervisory Authorities (CAPSA) is working towards a new multi-jurisdictional agreement for 2018 intended to recognize and account for differences in funding regimes among different jurisdictions. The divergence in approaches on solvency funding has raised some concerns about the current rule for following the funding rules of the major authority and the rule for allocating assets between jurisdictions. Some proposed methods for addressing these concerns would add another layer of complexity to determining the funding standards for a multi-jurisdictional plan. Adopting a distinct solvency funding framework that applies to federally regulated plans would further complicate the implementation of an agreement or potentially the ability for the federal government to become a signatory to an agreement.

Target Benefit Plans

While members of the CBA Section have differing views on target benefit plans and initiatives to introduce a regulatory framework for target benefit plans at the federal level, for example through Bill C-27[4], we agree that a target benefit plan framework should not be seen as a panacea for

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3 For example, in late 2016, BC amended its *Pension Benefits Standards Regulation* to permit DB plans meeting prescribed criteria to elect an extension of the regular solvency amortization period from 5 to 10 years and a consolidation of all prior solvency deficiencies. In late 2017, Alberta amended its *Employment Pension Plans Regulation* to establish a new commuted value payout option available to collectively bargained multi-employer plans that are under a solvency moratorium. In early 2018 Alberta further announced that it was accepting applications from DB plan administrators to extend the solvency deficiency amortization period by up to 10 years.

4 http://www.parl.ca/LegisInfo/BillDetails.aspx?Language=E&billId=8502232

concerns with the current funding framework for DB pension plans. Target benefit plans would not be an appropriate pension risk management solution in all workplace environments. In certain circumstances, a better balancing of pension risk and employee compensation objectives may be achievable in DB plans. The CBA Section supports a policy approach that takes into consideration the long term viability and sustainability of DB plans, separate from initiatives to give employers alternative design options.

In spite of this, some CBA Section members believe that target benefit plans reduce benefit security and shift risk onto members. They have concerns with key features of target benefit plans, namely the absence of an employer obligation to underwrite funding deficits, and an ability to reduce future benefits (and sometimes accrued benefits).

Other CBA Section members believe that a target benefit plan model may be more desirable and give greater retirement income security and adequacy relative to the defined contribution (DC) plan model and relative to DB plans that are terminated with insufficient assets to provide for all accrued benefits. Some CBA Section members also believe the target benefit plan offers greater overall predictability of both benefits and contributions than other plan models, pooling of longevity and investment risks, and flexibility of plan design to enhance sustainability. Further, the target benefit plan is generally an acceptable middle ground in truly strained financial circumstances where an existing DB plan is in jeopardy of being eliminated.

Approaches in Other Jurisdictions

Below we discuss solvency funding approaches taken in Alberta, British Columbia, Ontario and Québec. There are differing views on whether the elimination of solvency funding requirements (as in Québec) adequately balances the competing concerns of employees (benefit security) and employers (contribution and balance sheet volatility). That said, we believe these competing interests are better balanced by requiring solvency funding up to prescribed thresholds (as in Ontario) as compared to an outright elimination of solvency funding requirements (as in Québec). The CBA Section also generally supports measures to encourage funding of DB plans, including the ability to withdraw surplus subject to certain conditions and regulatory approval (as in Alberta and British Columbia).

Alberta and British Columbia - Alberta and British Columbia have preserved solvency funding requirements for DB plans and expanded the conditions for the withdrawal of surplus. DB plans may now create a separate solvency reserve account (SRA) in the plan's fund to hold solvency deficiency special payments to fund shortfalls. Employers are able to withdraw actuarial surplus if certain conditions are met. These measures alone are not expected to provide a long term solution for plan funding. Even with the introduction of SRAs (as well as target benefit plans), temporary solvency relief was announced in British Columbia in October 2016 and in Alberta in November 2017 and March 2018.

Ontario - On May 1, 2018, Ontario's new funding rules for DB plans came into effect. The new regime emphasizes going concern funding and includes a new funding reserve. The new regime includes the following measures:

1. Funding on a solvency basis is no longer required, except to the extent needed to bring the plan's funded status to 85% on a solvency basis;

2. The amortization period for funding a going concern shortfall is reduced from 15 years to 10 years;

3. It is necessary to add a reserve, called a Provision for Adverse Deviations (PfAD,) to going concern liabilities and to normal cost;

4. Going concern special payments can be consolidated into a single schedule whenever a new valuation report is filed;

5. Establishment of a special funding test for benefit improvements and enhanced requirements relating to contribution holidays as a means to improve benefit security; and

6. Transitional funding rules to allow for any funding increases as a result of the changes to be phased in over a three year period.

Québec - Québec made changes to its funding rules in 2016, pursuant to The *Act to amend the Supplemental Pension Plan Act* (Bill 57), which came into force on January 1, 2016. The legislation primarily amended the funding rules applicable to registered private sector DB pension plans in Québec. The most significant change was the elimination of solvency funding requirements. For funding on a going concern basis, a stabilization provision has to be established, with the target level determined by regulation. This stabilization provision is funded by additional current service contributions, separate amortization payments and actuarial gains.

Bill 57 reflects a labour-management consensus. It is the result of work of the *Comité consultatif du travail et de la main-d'œuvre* with representatives of both employer associations and large unions. In other words, both employer and union sides were involved in determining the new funding rules, and the end result reflects their perspectives and agreements.

Québec also recently introduced changes to the use of surplus assets, pursuant to Bill 149, *An Act to enhance the Québec Pension Plan and to amend various retirement-related legislative provisions*, enacted in February 2018. Bill 149 makes important changes to the rules about the use of surplus assets rules while a private sector DB plan is ongoing. We understand that some of these changes were made to reflect the labour-management consensus mentioned above.

Conclusion

The CBA Section appreciates the opportunity to comment on solvency funding rules. We will continue to follow with interest developments across Canada, including anticipated changes in Manitoba and Nova Scotia. In addition to facilitating harmonization, the CBA Section hopes that these ongoing discussions will lead to greater long term sustainability of pension plans. In our view, this will require greater intervention than the introduction of pension plan design features and we are in favour of changes to the funding framework of DB plans to support their future sustainability.

We trust that our comments are helpful and would be pleased to provide any further clarification.

Yours truly,

(original letter signed by Gaylene Schellenberg for Elizabeth Brown)

Elizabeth Brown
Chair, CBA Pensions and Benefits Law Section